LIBRARY
SUPREME COURT, U.S.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 5, 1949.

CERTIORARI GRANTED JANUARY 9, 1950.

United States Court of Appeals

EIGHTH CIRCUIT

No. 13,851

TAX REVIEW

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,
vs.
BROWN SHOE COMPANY, INC.,
RESPONDENT.

PETITION TO REVIEW DECISION OF THE TAX COURT OF THE UNITED STATES

FILED OCTOBER 27, 1948.

No. 13,852

TAX REVIEW

BROWN SHOE COMPANY, INC.,
PETITIONER,
vs.
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION TO REVIEW DECISION OF THE TAX COURT OF THE UNITED STATES

FILED NOVEMBER 1, 1948.

INDEX.

	Original	Print
Docket Entries	1	1
Petition of Brown Shoe Company, Inc	2	2
Assignment of Errors	3	3

	Original	Print
Statement of Facts	4	4
Prayers for Relief	11	8
Exhibit A, Notice to Brown Shoe Company, Inc., of Deficiency in Tax, May 16, 1946	14	10
Statement	15	11
Answer of Commissioner of Internal Revenue	25	20
Motion of Petitioner to Amend Petition	28	21
Opinion of The Tax Court of the United States	30	23
Order of Redetermination, April 30, 1948	34	26
Stipulation of Facts	35	27
Exhibits	44	35
1-A, Letter from certain Citizens of Charleston, Illinois, requesting Brown Shoe Company, Inc., to locate a Factory in their City, March, 1919, and acceptance by Brown Shoe Company, Inc.	44	35
2-B, Letter, Brown Shoe Company to C. L. Lee, October 28, 1924	46	39
3-C, Contract between Mattoon Association of Commerce of Mattoon, Illinois, and Brown Shoe Company, December 14, 1921	47	41
4-D, Proposition of certain Citizens of Mattoon, Illinois, made to Brown Shoe Company to induce it to locate a Factory in their City, March 7, 1928, and acceptance by Brown Shoe Company, Inc.	51	49
5-E, Contract between Chamber of Commerce of Union City, Tennessee, and Brown Shoe Company, November 29, 1922	54	55
6-F, Proposition of certain Citizens of Salem, Illinois, made to Brown Shoe Company, Inc., to induce it to locate a Factory in their City, January 3, 1925, and acceptance by Brown Shoe Company, Inc.	59	65
7-G, Letter, C. A. Porter, President, Salem Chamber of Commerce, to E. R. McCarthy, Vice President, Brown Shoe Company, October 20, 1927	61	69
8-H, Letter, L. W. Cline, Committee Chairman, to E. R. McCarthy, Vice President, Brown Shoe Company, Inc., May 23, 1925	62	71
9-I, Proposition of certain Citizens of Vincennes, Indiana, made to Brown Shoe Company, Inc., to induce it to locate a Factory in their City, December, 1925, and acceptance by Brown Shoe Company, Inc.	64	75
10-J, Agreement between Brown Shoe Company and Moberly Industrial Foundation, June 1, 1927	66	79
11-K, Proposition of Sullivan Community Club and Certain Citizens of Sullivan, Illinois, made to Brown Shoe Company to induce it to locate a Factory in their City, October, 1929, and Acceptance by Brown Shoe Company, Inc.	69	85

	Original	Print
12-L, Proposition of Pittsfield Development Association and certain Citizens of Pittsfield, Illinois, made to Brown Shoe Company, Inc., to induce it to locate a Factory in their City, November 20, 1933, and acceptance by Brown Shoe Company, Inc.	74	95
13-M, Letter to R. L. Harp, November 21, 1938	76	99
14-N, Proposition of certain Citizens of Caruthersville, Missouri, made to Brown Shoe Company, Inc., to induce it to locate a Factory in their City, June 15, 1934, and acceptance by Brown Shoe Company, Inc	77	101
15-O, Proposition of Citizens of Charleston, Missouri, made to Brown Shoe Company, Inc., to induce it to locate a Factory in their City, May, 1937, and acceptance by Brown Shoe Company, Inc	79	105
16-P, Proposition of Murphysboro Chamber of Commerce made to Brown Shoe Company to induce it to locate a Factory in Murphysboro, Illinois, March 22, 1939	81	108
17-Q, Statement of Brown Shoe Company, Inc., relating to Schedule of Cash Contribution showing Date of Receipt and Contract under which each Amount was received	82	109
18-R, Statement of Brown Shoe Company, Inc., relating to Receipt of Cash Contributed by Citizens of Sullivan, Illinois	85	113
19-S, Statement relating to Schedule of Amount contributed by Various Communities, etc	88	115
20-T, Statement relating to Cost of Property Acquired Pursuant to Agreements and Distribution of Net Amount of Contributions	90	119
21-U, Letter, Brown Shoe Company, Inc., to Commissioner of Internal Revenue, December 13, 1943	92	123
Transcript of Proceedings at Hearing	94	125
Appearances of Counsel	94	125
Proceedings	95	125
Motion of Petitioner for Leave to amend Petition and granting thereof	95	125
Opening Statement on Behalf of Petitioner	95	126
Waiver of Opening Statement on behalf of Respondent	101	129
Stipulation of Facts, Memorandum as to	101	129
Petition of Commissioner of Internal Revenue for Review of Decision of The Tax Court of the United States	102	129
Jurisdiction	104	130
Prior Proceedings	105	131
Nature of Controversy	105	131
Statement of Points	107	133
Notice of filing of Petition for Review by Commissioner of Internal Revenue and Acknowledgment of Service by Counsel for Respondent	109	134

	Original	Print
Notice of filing of Petition for Review by Commissioner of Internal Revenue and Acknowledgment of Service by Respondent	110	135
Petition of Brown Shoe Company, Inc., for Review of Decision of The Tax Court of the United States	111	135
Jurisdiction	111	136
Prior Proceedings	112	136
Nature of Controversy	113	137
Points Relied Upon	116	139
Notice of filing of Petition for Review by Brown Shoe Company, Inc., and Acknowledgment of Service	119	141
Joint Praecipe for Record	120	141
Clerk's Certificate to Transcript	122	143
Order of The Tax Court of the United States extending Time to file Record on Petitions for Review	123	144

Proceedings in U. S. Court of Appeals	145	145
Appearance of Mr. Theron Lamar Caudle and Mr. Ellis N. Slack as Counsel for Petitioner in Cause No. 13851	145	145
Appearance of Mr. Charles Oliphant and Mr. Charles E. Lowery as Counsel for Petitioner in Cause No. 13851	145	145
Appearance of Counsel for Respondent in Cause No. 13851	146	146
Appearance of Counsel for Petitioner in Cause No. 13852	146	146
Appearance of Mr. Theron Lamar Caudle and Mr. Ellis N. Slack as Counsel for Respondent in Cause No. 13852	147	146
Appearance of Mr. Charles Oliphant and Mr. Charles E. Lowery as Counsel for Respondent in Cause No. 13852	147	147
Appearance of Mr. Lee A. Jackson and Mr. Carlton Fox as Counsel for Commissioner of Internal Revenue in Causes Nos. 13851 and 13852	148	147
Order of Submission in Causes Nos. 13851 and 13852	149	148
Opinion in Causes Nos. 13851 and 13852	150	148
Judgment in Causes Nos. 13851 and 13852	163	161
Order enlarging time to August 2, 1949, to file petition of Brown Shoe Company, Inc., for rehearing in Causes Nos. 13851 and 13852	164	162
Petition of Brown Shoe Company, Inc., for Rehearing in Causes Nos. 13851 and 13852	165	163
Order denying Petition of Brown Shoe Company, Inc., for Rehearing in Causes Nos. 13851 and 13852	169	167
Clerk's Certificate to Transcript	170	167
Order allowing certiorari	171	168

Pleas and proceedings in the United States Court of Appeals for the Eighth Circuit, at the May Term, 1949, of said Court, before the Honorable Archibald K. Gardner, Chief Judge, and the Honorable Joseph W. Woodrough and the Honorable Seth Thomas, Circuit Judges.

Attest:

E. E. KOCH,
Clerk of the United States Court of Appeals for the Eighth Circuit.

(Seal)

Be it Remembered that heretofore, to-wit: on the 27th day of October, A. D. 1948, a record on petition to review decision of The Tax Court of the United States in the case of Commissioner of Internal Revenue, Petitioner, vs. Brown Shoe Company, Inc., Respondent, and on the 1st day of November, A. D. 1948, a record on petition to review decision of The Tax Court of the United States in the case of Brown Shoe Company, Inc., Petitioner, vs. Commissioner of Internal Revenue, Respondent, were filed in the office of the Clerk of the United States Court of Appeals for the Eighth Circuit.

Printed record on which the petitions to review were heard in said Court of Appeals is in the words and figures following, to-wit:

[fol. 1] Docket Entries.

Brown Shoe Company, Inc., Petitioner,
Docket No. 11394 vs.
Commissioner Of Internal Revenue, Respondent.

Appearances:

For Petitioner: Charles B. McInnis
For Respondent: George E. Gibson

1946

Jun. 24—Petition received and filed. Taxpayer notified. Fee paid.

Jun. 25—Copy of petition served on General Counsel.

Jul. 30—Answer filed by General Counsel.

Jul. 30—Request for hearing in St. Louis, Mo. filed by General Counsel.

Aug. 2—Notice issued placing proceeding on St. Louis calendar.
Service of answer and request made.

1947

Feb. 12—Hearing set 3/24/47, St. Louis, Mo.

Mar. 19—Motion for continuance to the next Circuit calendar to be held at St. Louis, Mo. filed, by taxpayer. 3/20/47 Granted.

Aug. 5—Hearing set Sept. 22, 1947, St. Louis, Mo.

Sept. 24—Hearing had before Judge Murdock on merits. Amended Petition and Stipulation of facts filed. Petitioner's Brief due 33 days; respondent's brief 30 days; petitioner's reply 15 days.

Oct. 16—Transcript of hearing 9/24/47 filed.

Oct. 27—Brief filed by taxpayer. 10/28/47 Copy served.

Nov. 26—Brief filed by General Counsel.

Dec. 8—Reply brief filed by taxpayer. 12/9/47 Copy served.

1948

Feb. 13—Opinion rendered, Judge Murdock. Decision will be entered under Rule 50 2/13/48 Copy served.

Apr. 21—Agreed computation for entry of decision filed.

Apr. 30—Decision entered, Judge Murdock, Div. 3.

Jul. 28—Petition for review by U. S. Court of Appeals, Eighth Circuit, with statement of points filed by General Counsel.

Jul. 28—Notice of petition for review sent to Charles B. McInnis filed. 7/30/48 Proof of service filed.

Jul. 30—Petition for review by U. S. Court of Appeals, Eighth Circuit, and statement of points filed by taxpayer.

Jul. 30—Proof of service filed by taxpayer.

Aug. 3—Proof of service of petition for review from taxpayer filed.

Aug. 19—Joint motion for extension to 10/26/48 to prepare and transmit the record filed.

Aug. 19—Order enlarging time to 10/28/48 to prepare and transmit the record entered.

Oct. 15—Joint praecipe for record filed.

[fol. 2] (Petition Of Brown Shoe Company, Inc.)

(Filed June 24, 1946, The Tax Court of the United States).

The Tax Court Of The United States

Brown Shoe Company, Inc., Petitioner
Docket No. 11394 v.
Commissioner Of Internal Revenue, Respondent

The above-named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commis-

sioner of Internal Revenue in his notice of deficiency (symbols IRA:90D:SL), dated May 16, 1946, and as a basis of this proceeding alleges as follows:

I. Petitioner is a corporation duly organized and existing under the laws of the State of New York, with its principal office at 16th and Washington, St. Louis, Missouri. The returns for the fiscal years ended October 31, 1942 and October 31, 1943, the periods herein involved, were filed with the Collector for the First District of Missouri at St. Louis.

II. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to Petitioner on May 16, 1946.

[fol. 3] III. The taxes in controversy are corporation excess profits taxes for the fiscal years ended October 31, 1942 and October 31, 1943, and are in the total amount of $143,983.46.

Assignments Of Error.

IV. The determination of tax set forth in the said deficiency notice is based upon the following errors:

(a) In computing Petitioner's taxable income for the fiscal years ended October 31, 1942 and October 31, 1943, the Commissioner of Internal Revenue erroneously added back to Petitioner's income, as otherwise computed, the amounts of $22,472.60 and $24,307.10, respectively, alleged to represent depreciation on donated properties.

(b) In computing Petitioner's taxable income for the fiscal years ended October 31, 1942 and October 31, 1943, the Commissioner of Internal Revenue erroneously failed to allow accelerated depreciation on Petitioner's depreciable property, which accelerated depreciation was sustained as a result of increased operation of Petitioner's plants, inadequate maintenance, poor quality of maintenance and supplies, untrained and careless employees and the additional wear and tear occasioned by the use of substitute manufacturing materials.

[fol. 4] (c) The Commissioner of Internal Revenue erroneously added to Petitioner's taxable income, as other-

wise computed, for the fiscal year ended October 31, 1943, an amount of $4250.00 representing a refund of floor stock tax received during the said fiscal year which Petitioner elected to have taxed at 1933 rates.

(d) In computing Petitioner's invested capital for the fiscal years ended October 31, 1942 and October 31, 1943, the Commissioner of Internal Revenue erroneously reduced the invested capital, as otherwise computed, by the amount of $971,031.01, alleged to represent capital contributed by various community groups.

Statement Of Facts.

V. The facts upon which Petitioner relies as the basis of this proceeding are as follows:

1. Petitioner corporation is engaged in the business of manufacturing and selling at wholesale men's, women's and children's shoes. Its manufacturing operations are conducted in a number of different plants located in small towns in the States of Missouri, Illinois, Indiana, and Tennessee.

2. During the period 1923 to 1943, Petitioner received from various community groups, such as Chambers of [fol. 5] Commerce and other civic organizations, lump sums in cash as an inducement to establish and operate a shoe factory in the particular town, or to enlarge and operate and existing shoe factory. In a few instances, Petitioner received land or the use of a factory building. However, in the majority of instances, Petitioner merely received lump sums in cash subject to certain clearly defined conditions set forth in a contract entered into between Petitioner and the contributing group.

3. All such contracts contained the specific provision that Petitioner establish and operate a factory in the particular town for a specified term of years, with the provision that if Petitioner should fail to meet either condition then it would be required to return to the contributing group the amount in question.

4. The amounts of such cash contributions were never sufficient to cover the cost of constructing the factory building and place it in condition to operate, and none of

the lump-sum-cash contributions received by Petitioner were ear-marked specifically for the construction or operation of any particular factory. All such cash payments were placed in Petitioner's general cash account and commingled with its other funds. The cost of constructing and operating the particular factory was paid from other funds.

5. The contracts between Petitioner and the contributing group required Petitioner to train and to employ [fol. 6) in its plant in the particular community local citizens of the particular community. Petitioner has found from experience that the cost of training an individual to perform any one of the numerous manufacturing operations required in the manufacture of shoes ranges between $100.00 and $200.00 each.

6. The Commissioner allocated the cash payments received by Petitioner during the period from 1923 to 1943, inclusive, between machinery and buildings, on the assumption that such cash contributions had been used exclusively in the construction and equipment of the factory in the particular community. He then disallowed depreciation on what he considered to be the portion of each factory building and the machinery therein acquired with contributed funds.

7. Petitioner contends that no part of its depreciation should be disallowed for either of the fiscal years ended October 31, 1942 and October 31, 1943, since the cash contributions were not ear-marked for the construction or equipment of a particular factory building, but, on the contrary, were commingled with Petitioner's other funds and used for general corporate purposes.

8. Petitioner contends, in the alternative, that if the cash contributions are to be considered as having been ear-marked for any particular factory, then such funds should likewise be considered as having been ear-marked for the cost of training new employees in the community and for the cost of fully equipping the particular factory [fol. 7] for operation, including the cost of opening inventory.

9. Prior to the fiscal year 1942, Petitioner had agreed with Representatives of the Bureau of Internal Revenue upon composite rates of depreciation which fairly reflect the wear and tear and obsolescence of Petitioner's buildings and machinery and equipment during normal operation.

10. Beginning about November 1, 1941, Petitioner found it necessary to accelerate to a marked extent the hours of operation of its various shoe factories, in order to meet the increased demand for shoes occasioned by the war-time conditions. Much of the increased demand came from military authorities. At the same time, Petitioner began to lose its trained factory and maintenance employees to the Army and to higher paying defense jobs. It was unable to keep up its regular standard of maintenance while, at the same time, being required to use new and poorly trained employees on its machines. Many of the employees realized that their work with Petitioner was of a temporary nature and consequently made no effort to protect Petitioner's buildings, machinery and equipment.. At the same time, Petitioner was unable to obtain sufficient parts and supplies, and in many instances was required to use substitute materials for the maintenance and repair of its machinery and equipment. It was also required to use substitute materials in its manufacturing operations, which occasioned increased wear and tear on its machinery. All of these factors resulted in heavy in- [fol. 8] creased wear and tear of Petitioner's buildings, machinery and equipment during the fiscal years 1942 and 1943.

11. Petitioner's officers assigned its Chief Engineer to make a detailed study of its plants and to submit reports setting forth his findings and opinion as to the extent to which the Company was suffering depreciation not reflected by the composite rates. The Chief Engineer made such a study and submitted to Petitioner's officers and directors separate reports on each of Petitioner's factories describing the conditions which he found, and also submitted a separate report giving the composite rates of depreciation which, in his opinion, the Company sustained during the fiscal years 1942 and 1943 as a result of the

abnormal operating conditions during those years. The report of the Company's Chief Engineer indicated that the Company sustained total composite depreciation at the rates indicated below for the classes of depreciable property indicated:

Buildings	5½%
Building Equipment	8½%
Roofs	12½%
Machinery	12%
Furniture and Fixtures	12%

The Commissioner of Internal Revenue refused to allow any additional depreciation for the fiscal years 1942 and 1943, whereas the Company in fact sustained depreciation at the composite rates indicated above. Petitioner hereby claims total depreciation at the composite rates indicated above.

[fol. 9] 12. During the fiscal year 1943, Petitioner received a refund of floor stock tax in the amount of $4250.00 which it had previously paid and deducted during the calendar year 1933. Under section 128 of the Internal Revenue Code, Petitioner is entitled to have the said amount taxed at 1933 rates instead of 1943 rates. Petitioner elected in its return for the fiscal year 1943 to have the said amount taxed at 1933 rates. The Commissioner of Internal Revenue refused to permit the said amount to be taxed at 1933 rates because Petitioner had appealed to this Court from a determination of its tax liability for that year.

13. In computing Petitioner's invested capital for the fiscal years ended October 31, 1942 and October 31, 1943, the Commissioner of Internal Revenue reduced the invested capital, as otherwise computed, by an amount of $971,031.01, alleged to represent contribution to capital by various community groups. This amount is apparently what the Commissioner considered to be the total of the cash contributions received by Petitioner from various community groups.

14. In computing its invested capital for the fiscal years 1942 and 1943, Petitioner claimed only money or property paid in for its stock under section 718(a)(1) and (2) and

accumulated earnings and profits at the beginning of each taxable year, under section 718(a)(4). It did not claim, and does not claim now, any paid in surplus or contributed capital.

15. The cash sums received by Petitioner from the various community groups during the years prior to 1942 were commingled with Petitioner's other funds and were used for general corporate purposes, including the payment of dividends. Such amounts became part of Petitioner's earnings and profits for the years in which received and were expended for Petitioner's general corporate purposes long before the beginning of Petitioner's fiscal yar 1942.

16. Petitioner claims that its accumulated earnings and profits at the beginning of the respective fiscal years may not be reduced by the amount of $971,031.01 or by any other amount alleged to represent sums which were contributed to and which became unqualifiedly subject to Petitioner's use for its general corporate purposes, prior to the beginning of the fiscal year 1942.

17. Petitioner contends, in the alternative, that if this Court should conclude that the cash contributions previously received by Petitioner may be ear-marked and segregated from Petitioner's accumulated earnings and profits, for invested capital purposes, then such amounts should be applied, first, to the payment of dividends made subsequent to the receipt of such sums, or, alternatively, such sums should be applied to subsequent dividends on a pro rata basis with Petitioner's other accumulated earnings and profits.

[fol. 11] Prayers for Relief

Wherefore, Petitioner prays that this Court may hear the proceeding and determine that no part of Petitioner's depreciation may be disallowed as a result of Petitioner's prior receipt of cash contributions from community groups.

Petitioner further prays, in the alternative, that if the Court should conclude that any part of the Petitioner's depreciation is to be disallowed as a result of its receipt of prior contributions from community groups, then the amount of each contribution should be applied, first, toward

the cost of training new employees in the particular community and the remainder, if any, applied pro rata over the cost of land, buildings, machinery and equipment, and opening inventory and the depreciation adjusted accordingly.

Petitioner further prays that this Court may determine that it is entitled to accelerated depreciation on its buildings, building equipment, roofs, machinery, and furniture and fixtures for the fiscal years 1942 and 1943.

Petitioner further prays that this Court may determine that the amount of $4250.00, received during the fiscal year 1943 as a refund of floor stock tax paid during the year 1933, is subject to tax at 1933 rates, and not at 1943 rates.

[fol. 12] Petitioner further prays that this Court may determine that Petitioner's accumulated earnings and profits may not be reduced by the amount of cash contributions received from community groups during prior years.

Petitioner further prays, in the alternative, that if this Court should determine that Petitioner's accumulated earnings and profits should be adjusted by reason of the receipt of contributions from community groups during prior years, then the Court should determine that such contributions should be applied, first, toward the payment of all dividends subsequent to the date of receipt, or, alternatively, toward the payment of such dividends on a basis pro rata with Petitioner's other accumulated earnings and profits.

Petitioner further prays for such other and further relief that this Court may deem proper on the basis of the facts adduced at the hearing.

Respectfully submitted,

CHARLES B. McINNIS
Transportation Building
Washington, D. C.
Attorney for Petitioner.

Of Counsel:
ROBERTS & McINNIS
Transportation Building
Washington, D. C.

[fol. 13] State of Missouri,
City of St. Louis.—ss:

C. P. Evans being duly sworn, deposes and says that he is secretary of Brown Shoe Company, Inc., the Petitioner named in the foregoing petition, and as such is authorized to verify the said petition; that he has read the foregoing petition and is familiar with the statements contained therein and that the statements contained therein are true to the best of his knowledge, information and belief.

(Seal) C. P. EVANS, Secy.

Subscribed to and sworn to before me this 19th day of June, 1946.

O. HASSELKUSS,
Notary Public.

My commission expires January 6, 1950.

[fol. 14] Exhibit "A"

Treasury Department
Internal Revenue Service

Office of
Internal Revenue Agent
in Charge
St. Louis Division
1767 Railway Exchange Bldg.
IRA:90D:SL

St. Louis, Missouri
May 16, 1946

Brown Shoe Company, Inc.,
1610 Washington Avenue,
St. Louis, Missouri

Gentlemen:

You are advised that the determination of your excess profits tax liability for the taxable years ended October 31, 1942 and October 31, 1943 discloses a deficiency of $143,983.46 and that the determination of your income tax liability for the years mentioned discloses an overassessment of $38,534.88 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, St. Louis, Missouri for the attention of EPB:HS. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner.

By: N. B. Eshleman,
Internal Revenue Agent in
Charge.

Enclosures:
Statement
Form of waiver &
acceptance
Forms 843

[fol. 15] Statement

IRA:90D:SL

Brown Shoe Company, Inc.,
1610 Washington Avenue,
St. Louis, Missouri

Tax Liability for the Taxable Years Ended October 31, 1942 and October 31, 1943

	Income Tax			
Year Ended	Liability	Assessed	Deficiency	Overassessment
10-31-1942	539,921.05	555,350.67		15,429.62
10-31-1943	$ 449,286.28	472,391.54		23,105.26
Totals	$ 989,207.33	1,027,742.21		38,534.88

		Excess Profits Tax	
10-31-1942	$1,002,314.18	944,079.09	58,235.09
10-31-1943	2,331,754.32	2,246,005.95	85,748.37
Totals	3,334,068.50	3,190,085.04	143,983.46

In making this determination of your income and excess profits tax liability, careful consideration has been given to the report of examination dated July 6, 1945; to your protest filed October 22, 1945; and to the statements made at the conference held on December 13, 1945.

The overassessments shown herein will be made the subject of certificates of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322(a) of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessments referred to in this letter, by filing with the collector of internal revenue for your district, claims for refund on Form 843, copies of which are enclosed, the basis of which may be as set forth herein.

A copy of this letter and statement has been mailed to your representative, Mr. Charles B. McInnis, Transportation Building, Washington, D. C., in accordance with the authority contained in the power of attorney executed by you.

[fol. 16]

Adjustments to Net Income
Taxable year ended 10-31-1942

Net income as disclosed by return		$2,845,921.57
Unallowable deductions and additional income:		
(a) Capital expenditures	7,492.27	
(b) Depreciation on donated properties	22,472.60	29,964.87
Total		2,875,886.44
Nontaxable income and additional deductions:		
(c) Capital stock tax		12,305.00
Net income adjusted		$2,863,581.44

Explanation of Adjustments

(a) The deduction for repairs as claimed on your return included $7,882.14 which were capital expenditures and the cost should be recovered through allowance for depreciation with net adjustment as follows:

Capital expenditures disallowed	$ 7,882.14
Less Depreciation allowed	389.87
Net disallowance	$ 7,492.27

(b) The deduction for depreciation as claimed on your return included $22,472.60 for depreciation on donated property or property acquired with donated funds which is held to be an unallowable deduction.

Your contention for allowance of accelerated rates for depreciation has not been substantiated.

(c) On your return you claimed a deduction of $40,820.00 for capital stock tax, whereas the information on file shows the correct amount to be $53,125.00 Income is therefore decreased by $12,305.00.

[fol. 17]

Computation of Tax

Taxable Year Ended 10-31-1942

Income Tax.

Normal Tax and Suftax at 1941 Rates:		
Taxable net income adjusted		$2,863,581.44
Less:		
Declared value excess profits tax	None	
Excess profits tax	837,884.35	
Dividends received credit	187,134.15	1,025,018.50
Net income subject to normal tax and surtax		$1,838,562.94
Normal tax:		
24% of $1,838,562.94		$ 441,255.11
Surtax:		
6% of $ 25,000.00	1,500.00	
7% of 1,813,562.94	126,949.41	$ 128,449.41
Total normal tax and surtax at 1941 rates		$ 569,704.52
Normal Tax and Surtax at 1942 Rates:		
Taxable net income adjusted		$2,863,581.44
Less:		
Declared value excess profits tax	None	
Income subject to excess profits tax	1,473,140.58	
Dividends received credit	187,134.15	$1,660,274.73
Net income subject to normal tax and surtax		$1,203,306.71
Normal tax:		
24% of $1,203,306.71		$ 288,793.61
Surtax:		
16% of $1,203,306.71		$ 192,529.07
Total normal tax and surtax at 1942 rates		$ 481,322.68

[fol. 18] Income tax at 1941 rates—$569,704.52

Allocable portion for period ending 6-30-1942: 242/365 of $569,704.52	$ 377,721.90
Income tax at 1942 rates—$481,322.68	
Allocable portion for period 6-30-42 to 10-31-42: 123/365 of $481,322.68	$ 162,199.15
Correct income tax liability	$ 539,621.05
Income tax assessed: Original, Account No. 410060	$ 555,350.67
Overassessment of income tax	15,429.62

Adjustment to Excess Profits Net Income
Computed under the Invested Capital Method
Taxable Year Ended 10-31-42

Excess profits	
Net income as disclosed by return	$ 2,663,943.35
Unallowable deduction and additional income:	
(a) Normal tax net income	17,659.87
Excess profits net income revised	$ 2,681,603.22

Explanation of Adjustment

(a) Adjustment to normal tax net income made herein result in a net increase of $17,659.87 in excess profits net income.

Adjustments to Invested Capital
Year ended 10-31-1942

Invested capital as disclosed by return		$17,412,367.14
Addition:		
(a) Decrease of reduction on account of inadmissible assets		$ 40,029.52
Total		$17,452,396.66
Deductions:		
(b) Accrued taxes	3,327.88	
(c) Contribution to capital by various community groups	971,031.01	$ 974,358.89
Invested capital adjusted		$16,478,037.77

[fol. 19] Explanation of Adjustments

(a) On your excess profits tax return you reduced average invested capital by $414,547.06 on account of inadmissible assets, whereas the information on file shows the correct amount to be $374,517.54. Invested capital is therefore increased by $40,029.52.

(b) The information on file shows the accrual for taxes was understated by the net amount of $3,327.88 which results in a decrease of invested capital by this amount.

(c) On your excess profits tax return you included in invested capital $971,-031.01 for money or property paid in by various community groups, and it is held that such contributions are not included in invested capital.

Computation of Excess Profits Credit
Based on Invested Capital

Invested capital adjusted		$16,478,037.77
Credit on $5,000,000.00 at 8%		400,000.00
Credit on 11,478,037.77 at 7%		803,462.64
Excess profits credit based on invested capital		$ 1,203,462.64

Computation of Adjusted Excess Profits Net Income
Taxable Year Ended 10-31-1942

Excess profits net income		$ 2,681,603.22
Less:		
Specific exemption	$ 5,000.00	
Excess profits credit	1,203,462.64	1,208,462.64
Adjusted Excess profits net income		1,473,140.58

[fol. 20] Computation of Excess Profits Tax
Taxable Year ended 10-31-1942

Excess Profits tax at 1941 rates:		
Adjusted Excess profits net income		$ 1,473,140.58
Excess profits tax:		
35% of $ 20,000.00		$ 7,000.00
40% of 30,000.00		12,000.00
45% of 50,000.00		22,500.00
50% of 150,000.00		75,000.00
55% of 250,000.00		137,500.00
60% of 973,140.58		583,884.35
Total excess profits tax computed at 1941 rates		$ 837,884.35
Excess Profits Tax at 1942 rates:		
Adjusted Excess profits net income		$ 1,473,140.58
90% of $1,473,140.58	(a)	1,325,826.52
Surtax net income		2,863,581.44
80% of $2,863,581.44		2,290,865.15
Income tax		481,322.68
Excess	(b)	$ 1,809,542.47
Total excess profits tax at 1942 rates lower of (a) or (b)		1,325,826.52

Excess profits tax at 1941 rates—$837,884.35	
Allocable portion for period ending 6-30-1942 242/365 of $837,884.35	555,528.80
Excess profits tax at 1942 rates—$1,325,826.52	
Allocable portion for period 6-30-42 to 10-31-42 123/365 of $1,325,826.52	446,785.38
Correct excess profits tax liability	$ 1,002,314.18
Excess profits tax assessed: Original Account No. 400028	944,079.09
Deficiency of excess profits tax	$ 58,235.09

[fol. 21]

Adjustments to Net Income
Taxable Year Ended 10-31-1943

Net income as disclosed by return		$ 3,066,046.01
Unallowable deductions and additional income:		
(a) Capital expenditures	$ 5,830.71	
(b) Capital stock tax	3,125.00	
(c) Refund of floor stock tax	4,250.00	
(d) Depreciation on donated properties	24,307.10	37,512.81
Net income adjusted		$ 4,003,558.82

Explanation of Adjustments

(a) The deduction for repairs as claimed on your return included $6,958.36 which were capital expenditures and the cost should be recovered through allowance for depreciation with the net adjustment computed as follows:

Capital expenditures disallowed			$ 6,958.36
Less: Depreciation thereon	347.91		
Depreciation on capital expenditures, F.Y. 10-31-42	779.74		$ 1,127.65
Net disallowance			$ 5,830.71

(b) On your return you claimed a deduction of $53,125.00 for capital stock tax, whereas the information on file shows the correct amount to be $50,000.00. Income is therefore increased by $3,125.00.

(c) The information on file shows that on May 26, 1943 you received a refund of $4,250.00 of floor stock tax paid on Aug. 1, 1933 which is held to be taxable income for the year in which received.

(d) The deduction for depreciation as claimed on your return, included $24,307.10 for depreciation on donated property or property acquired with donated funds, which is held to be an unallowable deduction.

Your contention for allowance of accelerated rates for depreciation has not been substantiated.

[fol. 22]

Computation of Tax
Taxable Year Ended 10-31-1943

Income Tax:

Normal Tax and Surtax:

Taxable net income		$ 4,003,558.82
Less:		
Net long term capital gain		$ 14,724.42
Adjusted net income		$ 3,988,834.40
Less:		
Declared value excess profits tax	None	
Income subject to excess profits tax	2,813,060.36	
Dividend received credit	61,761.13	2,874,821.49
Net income subject to normal tax and surtax		$ 1,114,012.91
Normal tax:		
24% of $1,114,012.91		$ 267,363.10
Surtax:		
16% of $1,114,012.91		$ 173,242.07
Total normal tax and surtax		$ 445,605.17
Add:		
25% of $14,724.42, net long term capital gain		3,681.11
Correct income tax liability		449,286.28
Income tax assessed:		
Original, account No. 410039		$ 472,391.54
Overassessment of income tax		23,105.26

Adjustment to Excess Profits Net Income
Computed Under the Invested Capital Method
Taxable Year Ended 10-31-1943

Excess profits net income as disclosed by return	$ 3,908,458.18
Addition:	
(a) Additional income	33,262.81
Excess profits net income revised	3,941,720.99

[fol. 23]

Explanation of Adjustment
Taxable Year Ended 10-31-1943

(a) The adjustments to normal tax net income of $37,512.81 included $4,250.00 for refund of floor stock tax paid in 1933 which was income attribu

table to other year and not included in excess profits net income. The net adjustment is computed as follows:

Normal tax net income increased	$ 37,512.81
Less: Refund of floor stock tax paid in 1933 not subject to excess profits tax	$ 4,250.00
Net increase in excess profits net income	33,262.81

Adjustments to Invested Capital
Taxable year ended 10-31-1943

Invested capital as disclosed by return		$17,261,229.90
Addition:		
(a) Decrease of reduction on account of inadmissible assets		20,862.89
Total		$17,282,092.79
Deductions:		
(b) Reduction of accumulated earnings and profits	83,384.61	
(c) Contributions to capital by various community groups	971,031.01	1,054,415.62
Invested capital adjusted		$16,227,677.17

Explanation of Adjustments

(a) On your excess profits tax return you reduced average invested capital by $341,838.91 on account of inadmissible assets, whereas the information on file shows the correct amount to be $320,976.02. Invested capital is therefore increased by $20,862.89.

(b) The accumulated earnings and profits as disclosed by your excess profits tax return should be reduced by the net amount of $83,384.61 computed as follows:

Capital stock tax accrual	$ 33,750.00
Increase federal income and excess profits tax accrual	41,523.63
Post war credit eliminated	15,603.25
Total	$ 90,876.88
Less: Capital items disallowed for year ended 10-31-1942 less depreciation	7,492.27
Net reduction of invested capital	$ 83,384.61

[fol. 24] (c) On your excess profits tax return you included in invested capital $971,031.01 for money or property paid in by various community groups, and it is held that such contributions are not includible in invested capital.

Computation of Excess Profits Credit
Based on Invested Capital
Taxable Year Ended 10-31-43

Invested capital adjusted		$16,227,577.17
Credit on $5,000,000.00 at 8%		400,000.00
Credit on 5,000,000.00 at 7%		350,000.00
Credit on 6,227,677.17 at 6%		373,660.63
Excess profits credit based on invested capital		$ 1,123,660.63

Computation of Adjusted Excess Profits Net Income
Taxable Year Ended 10-31-43

Excess profits net income		$ 3,941,720.99
Less:		
Specific exemption	$ 5,000.00	
Excess profits credit	1,123,660.63	1,128,660.63
Adjusted Excess profits net income		$ 2,813,060.36

Computation of Excess Profits Tax.
Taxable Year Ended 10-31-43

Adjusted excess profits net income		$ 2,813,060.36
90% of $2,813,060.36	(a)	2,531,754.32
Surtax net income		4,003,558.82
80% of $4,003,558.82		3,202,847.06
Income tax		449,286.28
Excess		$ 2,753,560.78
Excess profits tax liability, lower of (a) or (b)		$ 2,531,754.32
Less:		
Credit for debt retirement		200,000.00
Correct excess profits tax liability		$ 2,331,754.32
Excess profits tax assessed:		
Original, Account No. 400018		$ 2,246,005.95
Deficiency of excess profits tax		$ 85,748.37

[fol. 25] (Answer of Commissioner of Internal Revenue)

(Received and Filed July 30, 1946, The Tax Court of the United States)

The Tax Court of the United States

Brown Shoe Company, Inc., Petitioner,
Docket No. 11394. vs.
Commissioner of Internal Revenue, Respondent.

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein admits and denies as follows:

I. Admits the allegations of paragraph I.

II. Admits the allegations of paragraph II.

III. Admits the allegations of paragraph III.

Assignments of Error.

IV. (a) Denies that the Commissioner erred as alleged in paragraph IV (a).

(b) Denies that the Commissioner erred as alleged in paragraph IV (b).

(c) Denies that the Commissioner erred as alleged in paragraph IV (c).

(d) Denies that the Commissioner erred as alleged in paragraph IV (d).

[fol. 26] Statement of Facts.

V. 1. Admits allegations of paragraph V 1.

2. Admits the allegations of paragraph V 2.

3. Admits the allegations of paragraph V 3.

4. Denies the allegations of paragraph V 4.

5. Denies the allegations of paragraph V 5.

6. Denies the allegations of paragraph V 6.

7. Denies the allegations of paragraph V 7.

8. Denies the allegations of paragraph V 8.

9. Denies the allegations of paragraph V. 9.

10. Denies the allegations of paragraph V 10.

11. Denies the allegations of paragraph V 11.

12. Admits the allegations of the first sentence of paragraph V 12, but denies the remaining allegations of said paragraph.

13. Admits the allegations of the first sentence of paragraph V 13, but denies the remaining allegations of said paragraph.

14. Denies the allegations of paragraph V 14.

15. Denies the allegations of paragraph V 15.

16. Denies the allegations of paragraph V 16.

17. Denies the allegations of paragraph V 17.

VI. Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

[fol. 27] Wherefore, it is prayed that the appeal be denied.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
Orris Bennett,
Division Counsel.
Felix Atwood,
Special Attorney,
Bureau of Internal Revenue.

FA/meg 7/24/46

[fol. 28] (Motion of Petitioner to amend Petition)

(Filed at Hearing at St. Louis Missouri on September 24, 1947, The Tax Court of the United States)

Comes Now the Petitioner in the above-entitled proceeding by its attorney, Charles B. McInnis, and respectfully

moves that it be permitted to amend its petition in the following particulars:

Page 8, paragraph 14: Delete the last sentence of paragraph 14, which reads as follows: "It did not claim, and does not claim now, any paid in surplus or contributed capital."

Page 10, paragraph 1: Delete the word "cash" on the fourth line, so that the paragraph, as amended, will read as follows:

"Wherefore, Petitioner prays that this Court may hear the proceeding and determine that no part of Petitioner's depreciation may be disallowed as a result of Petitioner's prior receipt of contributions from community groups."

[fol. 29] Page 11, paragraph 1: Delete the word "cash" on the third line, so that the paragraph, as amended, will read as follows:

"Petitioner further prays that this Court may determine that Petitioner's accumulated earnings and profits may not be reduced by the amount of contributions received from community groups during prior years."

Page 11: Add the following paragraph immediately preceding the last paragraph on the page:

"Petitioner further prays in the alternative that if this Court should determine that any portion of the contributions received by Petitioner from community groups during prior years does not constitute a part of Petitioner's accumulated earnings and profits then this Court should determine that said contributions are includible in Petitioner's invested capital as money and property paid in "as a contribution to capital" within the meaning of section 718(a)(1) and (2) of the Internal Revenue Code."

Respectfully submitted,

CHARLES B. McINNIS,
Attorney for Petitioner.

[fol. 30] (Opinion of The Tax Court of the United States)

10 T. C. No. 35.

The Tax Court of The United States

Brown Shoe Company, Inc., Petitioner,
Docket No. 11394. vs.
Commissioner of Internal Revenue, Respondent.

Promulgated February 13, 1948.

Excess Profits Tax—Equity Invested Capital—Accumulated Earnings And Profits—Section 718(a)(4).—Accumulated earnings and profits within the meaning of section 718(a)(4) does not include cash and property transferred to a taxpayer by a community group to induce the petitioner to operate a factory in the community since no profit or income was shown to result from the transfer.

Excess Profits Tax—Equity Invested Capital—Contribution To Capital—Section 718(a)(1)(2).—Such a transaction does not create equity invested capital under section 718(a)(1) or (2). The McKay Products Corporation, 9 T. C. ....., (Dec. 8, 1947), followed.

Deductions — Depreciation—Basis—Donor's—Section 113(a)(2).—Buildings so transferred are not gifts and do not take the donor's basis under section 113(a)(2). The McKay Products Corporation, 9 T. C. ....., (Dec. 8, 1947), followed.

Deductions—Depreciation—Basis.—The taxpayer is entitled to use its cost as basis for depreciation on building built by it with its own funds despite the fact that it had received cash from some community group to induce it to locate and operate a factory in the community.

[fol. 31] Charles B. McInnis, Esq., for petitioner.

George E. Gibson, Esq., for the respondent.

Opinion.

Mudock, Judge: The Commissioner determined deficiences in excess profits tax of $58,235.09 and $85,748.37 for

the fiscal years ended October 31, 1942 and 1943. The issues for decision are whether the Commissioner erred (a) in excluding from equity invested capital $971,031.01, representing money and buildings received from communities in which the petitioner operated factories, and (b) in disallowing depreciation on the buildings thus acquired and on others supposedly built with the funds thus acquired. The facts have been stipulated.

The petitioner, a corporation, filed its returns for the years here in question with the collector of internal revenue for the first district of Missouri. It manufactures shoes in a number of small towns in Missouri, Illinois, Indiana, and Tennessee.

The petitioner, during the period 1919 up to October 31, 1939, received $885,559.45 in cash and $85,471.56 in buildings from various community groups in 12 different towns. There were contracts in all cases except one involving $10,000. Those contracts varied but generally required the petitioner to acquire a factory in the town and to operate it for a specified period of time. The amount involved was to be refunded if the conditions of the contract were not fulfilled. It seems proper to assume that the petitioner fulfilled all conditions attached to the transfers, since neither party suggests contrary.

The Commissioner, in determining the deficiencies, reduced the petitioner's equity invested capital by $971,031.01, representing the cash and the value of the buildings [fol. 32] received, as described above, prior to the first fiscal year involved herein. He stated that it was not includible but gave no further explanation. The petitioner contends that the cash and the stipulated bases of the buildings are a part of equity invested capital, either as a part of its "accumulated earnings and profits" under section 718 (a) (4) or as a "contribution to capital" under section 718 (a) (1) and (2). The petitioner did not realize taxable income as a result of the transfers. Frank Holton & Co., 10 B. T. A. 1317. Congress intended that only earnings or profits could be included in equity invested capital as "accumulated earnings and profits" un-

der subparagraph (4). This is not to say that the earnings or profits would have to represent taxable income, but only that there would have to be earnings or profits. The petitioner has failed to demonstrate that all or any part of the amounts in question represent earnings or profits. Cf. Frank Holton & Co., supra. It has already been held that transfers such as these do not become a part of equity invested capital under section 718 (a) (1) or (2) where, as here, the transferors were not stockholders. The McKay Products Corporation, 9 T. C. ....., (Dec. 8, 1947). Cf. Liberty Mirror Works, 3 T. C. 1018; Frank Holton & Co., supra.

Two buildings were included in the properties transferred to the petitioner, as described under the first issue. Those buildings were used during the taxable years by the petitioner in its business of manufacturing shoes. The cash received by the petitioner was deposited in its general bank account and "was not earmarked for or held intact and applied against the cost of the factory, machinery, equipment or other items applicable to the plant acquired or constructed in the particular community." The Commissioner, in determining the deficiency, disallowed depreciation claimed by the petitioner for each year on the two buildings contributed by citizens of the two com- [fol. 33] munities and he also disallowed "additional amounts which he determined to be the depreciation deducted by Petitioner for the respective taxable years on buildings and machinery acquired with the cash received by Petitioner from the community groups."

It was held in The McKay Products Corporation, supra, that the recipient does not receive a gift and therefore does not take the transferor's basis under section 113(a) (2) on buildings transferred to it as an inducement to locate its business in a particular place. It is held upon authority of that case that the Commissioner did not err in disallowing depreciation on those buildings computed upon the transferor's basis. However, no justification appears for the action of the Commissioner in disallowing depreciation on buildings, machinery and equipment upon the theory that the petitioner used cash received

from the various communities to pay for those buildings and that machinery, and, consequently, the buildings and machinery had, to that extent, no cost to the petitioner. The parties have stipulated that the cash was not earmarked in any way and it is just as reasonable to assume that it was used for any one of a dozen other purposes as it is to make the Commissioner's assumption. The petitioner paid for the buildings and machinery out of its own unrestricted funds, those buildings and that machinery had cost to it, as shown on its books and records, and it is entitled to depeciation thereon.

The parties have settled one issue by the stipulation. The petitioner attempted to raise an issue about the treatment of the recovery of some floor stock tax, but it does not relate to the deficiencies and the Tax Court has no jurisdiction over that matter, as the parties themselves agree in their briefs.

Decision will be entered under Rule 50.

(Seal of The Tax Court of The United States).

[fol. 34] (Order of Redetermination, April 30, 1948.)

The Tax Court Of The United States
Washington

Brown Shoe Company, Inc., Petitioner,
Docket No. 11,394. vs.
Commissioner Of Internal Revenue, Respondent.

Decision.

Pursuant to the Court's opinion promulgated February 13, 1948, the parties herein filed an agreed computation of tax on April 21, 1948. In accordance with said computation, it is

Ordered and Decided: That there are deficiencies in excess profits tax of $52,398.09 and $52,347.92 for the fiscal

years ended October 31, 1942 and October 31, 1943, respectively.

J. E. MURDOCK,
Judge.

Enter: Entered Apr. 30, 1948.

Seal
The Tax Court
of the
United States

[fol. 35] Stipulation of Facts.

(Filed at Hearing at St. Louis, Missouri on September 24, 1947, The Tax Court of the United States.)

The Tax Court Of The United States

Brown Shoe Company, Inc., Petitioner,
Docket No. 11,394. vs.
Commissoner Of Internal Revenue, Respondent.

It is stipulated and agreed, by and between counsel for the respective parties hereto, that the facts hereinafter stated are true and correct and that this stipulation may be offered in evidence in the trial of this cause by either party with the same force and effect as if the same were duly proven by the testimony of witnesses, reserving to each party the right to object on grounds of materiality and relevancy of any fact admitted herein and reserving to each party the right to offer further evidence not inconsistent herewith.

1. Petitioner is a corporation duly organized and existing under the laws of the State of New York, with its principal office at 16th and Washington, St. Louis, Missouri. The returns for the fiscal years ended October 31, 1942 and October 31, 1943, the periods herein involved, were filed with the Collector for the First District of Missouri at St. Louis.

[fol. 36] 2. Petitioner is engaged in the business of manufacturing and selling at wholesale men's, women's and

children's shoes. Its manufacturing operations are conducted in a number of different plants located in small towns in the states of Missouri, Illinois, Indiana, and Tennessee.

3. On December 21, 1914, certain citizens of Dixon, Illinois, paid to Petitioner the sum of $10,000. The said payment was not made the subject of a written contract between Petitioner and the contributing citizens. The only written reference to the said payment of $10,000 is the following excerpt from the minutes of the meeting of Petitioner's Board of Directors held on January 5, 1915:

"The Committee, consisting of the President, Mr. G. W. Brown, and Vice Presidents, A. Theis and J. A. Bush, appointed in the matter of ground and factory buildings at Dixon, Illinois, reported the purchase of same at a cost of Sixty Thousand ($60,000) Dollars and accrued interest, and that title to same is now in the name of Brown Shoe Company, Inc. Also, that the citizens of Dixon had paid us a bonus of Ten Thousand ($10,000) Dollars as a part of our organization expenses in starting the factory there."

4. In addition to the payment of Ten Thousand ($10,000) Dollars referred to in the preceding paragraph, petitioner received during the period from May 1, 1919, to July 31, 1939, cash payments in the aggregate amount of $875,559.45, and buildings having a value of $85,471.56 from community groups in the cities and towns set forth below. The said payments were made pursuant to written contracts between Petitioner and the respective community groups, copies of said contracts being attached hereto as [fol. 37] Exhibits "1-A to 16-P inclusive. The name of the community making the payment, the date of the contract pursuant to which the payment was made, and the amount of the cash and property paid to [P itionery] are set forth below:

Community Making the Contribution	Date of Contract	Amount of Cash And Property Contributed
Charleston, Illinois	4-14-1919	$ 98,000.00
Charleston, Illinois	10-28-1924	25,000.00
Mattoon, Illinois	12-14-1921	11,006.65

Mattoon, Illinois	3- 7-1928	108,552.80	
Union City, Tennessee	11-29-1922	98,000.00	
Salem, Illinois	1- 3-1925	100,000.00	
Salem, Illinois	10-24-1927	25,000.00	
Litchfield, Illinois	5-23-1925	25,000.00	
Vincennes, Indiana	12-15-1925	100,000.00	
Moberly, Missouri	6- 1-1927	74,000.00	
Sullivan, Illinois	10- -1929	100,000.00	
Pittsfield, Illinois	11-20-1933	55,251.93	(Buildings 20,251.93)
Pittsfield, Illinois	11-21-1938	6,000.00	(Cash 41,000.00)
Caruthersville, Missouri	6-15-1934	65,219.63	(All Buildings)
Charleston, Missouri	6-14-1937	60,000.00	
Murphysboro, Illinois	3-22-1939	10,000.00	
Total		$961,031.01	

5. Petitioner received from the citizens of Pittsfield, Illinois, buildings having a value of $20,251.93. The deed to the said buildings, including the land on which the buildings were located, but which was not taken up on Petitioner's books, was delivered to Petitioner on December 1, 1933, and title to said property has been held by Petitioner continuously since that date. The said buildings were used by Petitioner in its business of manufacturing shoes during each of the fiscal years ended October 31, 1942, and October 31, 1943. The balance of the amount indicated in paragraph [fol. 38] 4 as having been received from the citizens of Pittsfield, Illinois, was received in cash.

6. The entire amount indicated in paragraph 4 hereof as an amount received by Petitioner from the citizens of Caruthersville, Missouri, consisted of buildings having a value of $65,219.63. The deed to the said buildings, including the land on which the buildings were located, which land was not taken up on Petitioner's books, was delivered to Petitioner on July 12, 1934, and title has been held by Petitioner continuously since that date. Said buildings were used by Petitioner in its business of manufacturing shoes during each of the fiscal years ended October 31, 1942, and October 31, 1943.

7. The date of receipt by Petitioner Corporation of each cash payment, including the payment from the citizens of Dixon, Illinois, is set forth on Exhibit "17Q" attached hereto.

8. The total amount of cash and value of buildings received by Petitioner from community groups, so far as material to the issues raised in this case, is as follows:

Cash received from citizens of Dixon, Illinois, December 21, 1914, (no contract)	$10,000.00
Cash payment received from the communities pursuant to the contracts referred to in paragraph 4 hereof	875,559.45
Buildings received from the citizens of Pittsfield, Illinois, as indicated in paragraph 5 hereof	20,251.93
Building received from the citizens of Caruthersville, Missouri, pursuant to the contract dated June 15, 1934, as indicated in paragraphs 4 and 6 hereof	65,219.63
Total	$971,031.01

[fol. 39] Petitioner also received from certain of the community groups, as indicated by Exhibits "1-A" to "16-P" inclusive, title to certain land. The said land was not taken up by petitioner on its books and is not included in the above mentioned total, and may be disregarded for the purposes of this proceeding.

9. Certain of the cash payments received by Petitioner from the community groups indicated in paragraphs 3 and 4 hereof, when received by Petitioner, were credited directly to Petitioner's Earned Surplus Account. The other cash payments referred to in paragraph 4 hereof, when received, were credited to Contributed Surplus on the liability side of the Petitioner's ledger and subsequently transferred to Petitioner's Earned Surplus Account. The value of the buildings was set up in a Building Account on the asset side of Petitioner's ledger and thereafter carried as an asset. The cash when received was deposited in Petitioner's general bank account and debited to Cash on the asset side of Petioner's ledger. The cost of constructing the buildings and the additions, machinery, etc., was paid from Petitioner's general bank

account, and debited to Cost of Buildings, Cost of Equipment, or Cost of Machinery, depending upon the nature of the particular expenditure, for the plant in question. The cash received by Petitioner from a particular community group was not earmarked for or held intact and applied against the cost of the factory, machinery, equipment, or other items applicable to the plant acquired or constructed in the particular community. There are at- [fol. 40] tached hereto, as Exhibit "18-R", typical journal entries from Petitioner's books reflecting the receipt by Petitioner of the building from the citizens of Caruthersville, Missouri, and journal entries reflecting the receipt by Petitioner of cash from the citizens of Sullivan, Illinois, together with entries reflecting the construction of Petitioner's new plant at Sullivan, Illinois.

10. Respondent reduced Petitioner's invested capital for each of the fiscal years ended October 31, 1942, and October 31, 1943, by the amount of $971,031.01, representing the cash and the value of the buildings received by Petitioner prior to November 1, 1941. He also disallowed, in computing Petitioner's taxable income, for each of the fiscal years ended October 31, 1942, and October 31, 1943, depreciation claimed by Petitioner on the buildings received from the citizens of Pittsfield, Illinois, and Caruthersville, Missouri, as indicated in paragraphs 5 and 6 hereof. Respondent also disallowed, in computing Petitioner's taxable income for the fiscal years ended October 31, 1942, and October 31, 1943, additional amounts which he determined to be the depreciation deducted by Petitioner for the respective taxable years on buildings and machinery acquired with the cash received by Petitioner from the community groups referred to in paragraph 4 hereof.

11. In every instance the cash received by Petitioner from the community groups, as set forth in paragraphs 3 and 4 hereof, was less than the amount expended by Petitioner for the acquisition or construction of the factory building and the machinery of said factory. In determining the amount of depreciation to be disallowed for the [fol. 41] fiscal years ended October 31, 1942, and October 31, 1943, attributable to the assets acquired with the con-

tributed cash, Respondent first determined the total cost to Petitioner of the factory building, the land, in instances where land was purchased by Petitioner, and the machinery and he then allocated the cash contribution received by Petitioner from the citizens of the particular community to the cost of buildings, land, in instances where land was acquired, and machinery, in the ratio of the total cost of each of said items to the aggregate cost of all of said items for the particular factory. There is attached hereto, marked Exhibit "19-C", a photostatic copy of Exhibit "N" of the revenue agent's report, covering an examination of Petitioner's books and records for the fiscal years ended October 31, 1942, and October 31, 1943.

12. If the Court determines that Petitioner is entitled to depreciation on the buildings received by Petitioner from the citizens of Pittsfield, Illinois, and from the citizens of Caruthersville, Missouri, the basis for computing depreciation on said buildings under Section 113 (b) of the Internal Revenue Code, shall be the amounts set forth in paragraphs 5 and 6 hereof, namely $20,251.93 and $65,-210.63 respectively.

13. If the Court determines that Petitioner is entitled to include in its invested capital, for the taxable years here involved, any amount attributable to the buildings received from the citizens of Pittsfield, Illinois, and Caruthersville, Missouri, the basis of said buildings for inevsted capital purposes shall be the amounts indicated in paragraphs 5 and 6 hereof, namely $20,251.93 and $65,219.63 respectively.

[fol. 42] 14. The Petitioner found it necessary to train new employees for employment in the new or enlarged factories which it established in the communities indicated in paragraphs 3 and 4 hereof. The cost of training such new employees was not less than $100.00 for each new employee. Before the newly established factory, or the addition to a previously established factory, could be operated, it was necessary for Petitioner to supply the factory with an opening inventory of the materials necessary for the manufacture of shoes. The cost of training the new employees and the cost of the opening inventory for each

new or enlarged factory established in said communities was deducted by Petitioner and allowed by Respondent in computing Petitioner's taxable income for the respective taxable years in which incurred. Exhibit "20-T" attached hereto shows the cost of training the new employees and the cost of the opening inventory, together with the cost of the building, cost of machinery, and the cost of land, in instances where land was purchased, for each new or enlarged factory, with respect to which Petitioner received a cash contribution. Respondent does not agree to the method of allocation reflected by said Exhibit, and objects to the matters set forth in the Exhibit and in this paragraph as irrelevant and immaterial.

15. On May 26, 1943, Petitioner recovered from the United States Government floor stock tax in the amount of $4,250.00 which tax it had paid on August 1, 1933, and had deducted in computing its taxable income for the fiscal year ended October 31, 1933. At the time of filing [fol. 43] its income and Excess Profits Tax Returns for the fiscal year ended October 31, 1943, Petitioner filed with the Commissioner a document bearing date of December 13, 1943, which it intended as a compliance with the provisions of Section 128 of the Internal Revenue Code. A photostatic copy of said document is attached hereto, marked Exhibit "21-U".

16. The Commissioner of Internal Revenue determined a deficiency in income tax against Petitioner for its fiscal year ended October 31, 1933. Petitioner appealed to the United States Board of Tax Appeals (Docket 83315.) Under date of January 28, 1938, the United States Board of Tax Appeals entered, pursuant to a written stipulation signed by counsel for the parties to that proceeding, a decision which closed that proceeding.

17. Respondent included the said amount of $4,250.00 in Petitioner's taxable income, subject to the corporation income tax, but not in Petitioner's excess profits net income subject to excess profits tax, for the fiscal year ended October 31, 1943.

18. Petitioner is entitled to depreciation on its machinery at the rate of 8-⅓% instead of the rate of 7% previously determined by Respondent, for each of the fiscal years ended October 31, 1942, and October 31, 1943. The rates of depreciation, determined by Respondent for Petitioner's other classifications of depreciable property, are correct, for each of the taxable years ended October 31, 1942, and October 31, 1943.

CHAS. B. McINNIS
Counsel for Petitioner.

CHARLES OLIPHANT (OB)
Chief Counsel, Bureau of Internal Revenue Counsel for Respondent.

Charleston, Illinois. March 1919.

Brown Shoe Company, Inc.,
St Louis, Missouri.

Gentlemen:

The undersigned citizens of the City of Charleston, Coles County, State of Illinois, in behalf of themselves and other citizens of said city whom they represent, make you the following proposition to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business of said City of Charleston, namely:

1st. Within ten days after signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed free and clear of all liens and incumbrances a suitable site, such as will be satisfactory to you, for the locating of the factory buildings to be erected by you.

2nd. We will supply the site so selected with the necessary water mains to bring into the premises the city water for use in the factory (or factories) for factory purposes and for the needs of the employees employed therein.

We will also connect said premises with the city sewers for all practicable purposes.

We will connect said premises with the gas mains of the city.

We will connect said premises with electric power wires.

We will construct and complete pavement and sidewalks to the factory buildings and in front of the same, so as to make the factory site accessible from the different points of the compass, and to be completed within sixty days after proposed factory buildings have been erected.

We will construct and complete switch and sidetracks, suitable to Brown Shoe Company, in accordance with the requirements of its business, connecting the factory buildings with Clover Leaf Railroads.

3rd. We agree to pay you or place at your disposal the sum of one hundred thousand ($100,000) dollars in cash, to be used for the payment of suitable factory building or buildings and the equipment thereof including power and lighting plants, a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevators and the necessary machinery, etc., for the manufacture of shoes: said factory building or buildings to be erected upon the site selected.

6th. It is understood between the parties hereto that Brown Shoe Company, Inc., shall in good faith continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit. It is further understood that the main factory building shall be not less than 40 feet X 250 feet, three stories high, and employ four hundred (400) employees when operated to its full capacity, also that the amount paid out for labor shall be not less than one million two hundred fifty thousand ($1,250,000) dollars during the period of the first ten years, provided and adequate supply of labor is obtainable.

It is understood and agreed that the Brown Shoe Company Inc shall construct said building of brick and shall invest in the construction and equipment of said building over and above the one hundred thousand ($100,000) dollars furnished by the citizens of Charleston, not less than one hundred thousand ($100,000) dollars.

It is understood that said Brown Shoe Company, Inc., will carry insurance sufficient in amount to cover the cost of said building or buildings, and in the event of the total or partial destruction of the factory buildings by fire or other casualties the insurance money received by Brown Shoe Company, Inc., shall be employed in the reconstruction or repair thereof without unnecessary delay.

7th. Brown Shoe Company, Inc., shall, if it accepts this proposition, operate said plant continuously so long as it is practicable in the conduct of its business for at least a period of ten years; but in the event Brown Shoe Company, Inc., shall within said period of ten (10) years elect to discontinue the manufacture of shoes at Charleston for any cause, Brown Shoe Company, Inc., shall in that event reconvey to the undersigned Citizens Committee, or their successors, to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interests may appear, the factory site and buildings and equipments and shoe making machinery, free of all incumbrances.

But it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc., has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only so long as necessary.

8th. We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

Yours truly,

Mr. C. L. Lee,
Charle ton, Ill.

Dear Sir:-

In consideration of the payment to us of $25,000. ($10,000 to be paid on or before December 1st, $10,000 on or before February 1st, $5,000 on or before April 15th.) We agree to proceed at once with the erection of a 100 foot, three story addition to our factory. The same height and width and uniform with present building. In connection with this addition will be a three story stem, to house the necessary coat rooms and toilet facilities. We plan also to build a one story addition, about 15 feet by 39 feet for the factory office, as well as an addition to the present cement house.

These ad itions will require us to install at once a second engine and generator and another boiler.

This will make our plant in Charleston, the largest of our out-of-town factories. We appreciate, as we believe you know, the splendid co-operation and assistance we have had from you and your associates, in your Chamber of Commerce, from the very first day the original factory was talked about, and we look forward with confidence to a bigger and better Charleston factory.

Very cordially yours,

C O N T R A C T

WHEREAS, the Brown Shoe Company of St. Louis, Missouri, and the Mattoon Association of Commerce of Mattoon, Illinois, entered into a contract, under date of June 14th, 1921, which has been fully performed and carried out by both parties to this date, and

WHEREAS, the said Brown Shoe Company is desirous of enlarging and operating on a more extensive scale, its branch factory at Mattoon, Illinois, and said Association of Commerce is willing and desirous of having this done by the said Brown Shoe Company, and negotiations have been pending between the parties for some time, and

WHEREAS, J. O. Reynolds, of Mattoon, Illinois, is this day accordingly entering into a lease with the said Brown Shoe Company for the premises owned by him on Sixteenth Street in Mattoon, Illinois, in a portion of which the present factory of the said Company has been and is being operated under said contract, dated June 14, 1921, and the new lease includes also the entire second floor of the two-story brick building owned by said J. O. Reynolds at said location, and that part of the

NOW, THEREFORE, IN CONSIDERATION OF THE PREMISES AND THE MUTUAL COVENANTS AND AGREEMENTS OF THE PARTIES HERETO, IT IS HEREBY AGREED BY AND BETWEEN THE SAID Association of Commerce, party of the first part, and said Brown Shoe Company, party of the second part, as follows:

FIRST: In consideration of the said Brown Shoe Company enlarging and operating on a more extensive scale, as hereinafter provided, its factory for a period of six years in said demised premises from February 1st, 1922, and for an additional five years in case Lessee exercises its option, said first party will furnish free so far as second party is concerned, or pay the general personal property tax of said party of the second part in said period assessed by the local Assessor, and will also furnish free, so far as second party is concerned, or pay for the water for the lavatory and toilet purposes used by said party of the second part, in the operation of its said factory, and will also pay to said Brown Shoe Company the sum of ONE THOUSAND EIGHT HUNDRED and THIRTY-SIX and 66/100 DOLLARS($1836.66) annually, beginning with February 1st, 1923, each

of other similar industries, employing female labor in Mattoon, Illinois so long as said second party shall employ all such available labor, or shall be unable in the exercise of due diligence to obtain such labor.

THIRD: Said second party agrees that it will enlarge and operate on a more extensive scale its said factory so as to occupy the whole of said demised premises in said new lease, so entered into with said J. C. Reynolds, and that it will accordingly employ at all times, at least, Two Hundred and Fifty employees and from that number up to Three Hundred and fifty employees during such period provided, however, that during the first Three Months from February 1st, 1922, it shall not be required to employ more than One Hundred and Seventy-five employees which force shall be gradually increased, so that at the end of such first Three Months period, at least Two Hundred and fifty employees as aforesaid, shall be then regularly employed at all times, strikes, acts of Providence and conditions beyond its control excepted.

FOURTH: The contract entered into under date of June 14, 1921 is to be cancelled and superseded by this contract, provided, however, that it shall not be considered cancelled and

locating of the factory buildings to be erected by you.

2nd. We will supply the site so selected with the necessary water mains to bring into the premises the city water for use in the factory (or factories) for factory purposes and for the needs of the employees employed therein.

We will also connect said premises with the city sewers for all practicable purposes.

We will connect said premises with the gas mains of the city.

We will connect said premises with electric power wires.

We will construct and complete pavement and sidewalks to the factory buildings and in front of the same, so as to make the factory site accessible from the different points of the compass, and to be completed within sixty days after proposed factory buildings have been erected.

We will construct and complete switch and sidetracks, suitable to Brown Shoe Company, in accordance with the requirements of its business, connecting the factory buildings with Clover Leaf Railroads.

3rd. We agree to pay you or place at your disposal the sum of one hundred thousand ($100,000) dollars in cash, to be used for the payment of suitable factory building or buildings and the equipment thereof including power and lighting plants, a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevators and the necessary machinery, etc., for the manufacture of shoes: said factory building or buildings to be erected upon the site selected.

4th. We agree to have all taxes and license fees, including water, property coming to the City of Charleston rebated by said City for a period of ten years.

5th. Upon the acceptance of this proposition and when the site has been selected and the deed to the property has been delivered to Brown Shoe Company, Inc., and the one hundred thousand ($100,000) dollars have been secured so that the sum shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon, Brown Shoe Company, Inc., shall proceed without delay to construct and complete the necessary factory buildings and to equip the same as herein contemplated provided said payments shall not be called for until a certificate of the architect or person in charge of construction shall certify that materials or labor has been furnished of value equal to such payments asked for, and it shall have the same completed at the earliest practicable time: it being understood that ten thousand ($10,000) dollars of the said one hundred thousand ($100,000) dollars shall be paid to Brown Shoe Company, Inc., when the contract or contracts for the buildings is or are signed by the contractors and the Company, and the remaining ninety thousand ($90,000) dollars shall be paid in installments of ten thousand ($10,000) dollars, as requested by Brown Shoe Company, Inc., to make payments for said buildings and the equipment thereof. It is further agreed that the total sum of one hundred thousand ($100,000) dollars shall be available for the purpose of making final payments for the factory and the equipment thereof within one hundred and twenty (120) days from the date of this contract.

EXHIBIT 1-A
SHEET 1

event of the total or partial destruction of the factory buildings by fire or other casualties the insurance money received by Brown Shoe Company, Inc., shall be employed in the reconstruction or repair thereof without unnecessary delay.

7th. Brown Shoe Company, Inc., shall, if it accepts this proposition, operate said plant continuously so long as it is practicable in the conduct of its business for at least a period of ten years; but in the event Brown Shoe Company, Inc., shall within said period of ten (10) years elect to discontinue the manufacture of shoes at Charleston for any cause, Brown Shoe Company, Inc., shall in that event convey to the undersigned Citizens Committee, or their successors, to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interests may appear, the factory site and buildings and equipments and shoe making machinery, free of all incumbrances.

But it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc., has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only so long as necessary.

8th. We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

9th. We will furnish you rent free, for temporary use until the factory building is ready for occupancy, a room to be used for educating girls in stitching uppers, you to pay for cost of power, we to pay for bringing wiring to said room or building.

Charleston Merchants Association

C.L. Lee, President.

H. C. Welch, Secretary

IN DUPLICATE.

Brown Shoe Company, Inc., hereby accepts the foregoing proposition and agrees to be bound by the terms thereof.

April 14-1919

BROWN SHOE COMPANY, Inc.

Vice-President.

ATTEST: Secretary

EXHIBIT 1-A
SHEET 2

37

EXHIBIT 4-D

on or before February 1st, we [illegible] April 15th.) We agree to proceed at once with the erection of a 100 foot, three story addition to our factory. The same height and width and uniform with present building. In connection with this addition will be a three story stem, to house the necessary coat rooms and toilet facilities. We plan also to build a one story addition, about 15 feet by 39 feet for the factory office, as well as an addition to the present cement house.

These additions will require us to install at once a second engine and generator and another boiler.

This will make our plant in Charleston, the largest of our out-of-town factories. We appreciate, as we believe you know, the splendid co-operation and assistance we have had from you and your associates, in your Chamber of Commerce, from the very first day the original factory was talked about, and we look forward with confidence to a bigger and better Charleston factory.

Very cordially yours,

BROWN SHOE COMPANY,

By E. M. Faulkner

October 27-1924

KRMc-a

The above conditions are hereby accepted and will be fulfilled by the Chamber of Commerce and the people of Charleston and which pledge I am ready to guarantee

Reduction

C. A. Lee

factory at Mattoon, Illinois, and said Association of Commerce is willing and desirous of having this done by the said Brown Shoe Company, and negotiations have been pending between the parties for some time, and

WHEREAS, J. O. Reynolds, of Mattoon, Illinois, is this day accordingly entering into a lease with the said Brown Shoe Company for the premises owned by him on Sixteenth Street in Mattoon, Illinois, in a portion of which the present factory of the said Company has been and is being operated under said contract, dated June 14, 1921, and the new lease includes also the entire second floor of the two-story brick building owned by said J. O. Reynolds at said location, and that part of the ground-floor room of said building, which has been occupied by the Central Illinois Public Service Company, said new lease being for a term of six years from February 1st, 1922 with an option to said lessee of five years more, the entering into of which lease is a condition precedent to the entering into of this contract between said Association of Commerce and the said Brown Shoe Company, and

WHEREAS, said Brown Shoe Company and said J. O. Reynolds and said Association of Commerce are familiar with the terms and provisions of said lease, so being entered into this day, and said Brown Shoe Company and said Association of Commerce are, therefore, ready, and willing to enter into this contract

14-a

enlarging and operating on a more extensive scale, as hereinafter provided, its factory for a period of six years in said demised premises from February 1st, 1922, and for an additional five years in case Lessee exercises its option, said first party will furnish free so far as second party is concerned, or pay the general personal property tax of said party of the second part in said period assessed by the local Assessor, and will also furnish free, so far as second party is concerned, or pay for the water for the lavatory and toilet purposes used by said party of the second part, in the operation of its said factory, and will also pay to said Brown Shoe Company the sum of ONE THOUSAND EIGHT HUNDRED and THIRTY-SIX and 66/100 DOLLARS($1836.66) annually, beginning with February 1st, 1923, such sums to be paid in instalments, as follows, to-wit:

Annual payments on the First day of February of each succeeding year during the term of six years and not applying to the five year option, such payments are to be made only in the event the Brown Shoe Company shall operate said enlarged plant continuously and employ at least Two Hundred Fifty employees at all times, and should they fail to do so then said payments are to cease for such time as they fail to operate such enlarged plant.

SECOND; Said first party also agrees to furnish cooperation towards securing female labor for said second party in the operation of its said factory, and will not solicit or encourage the location

number up to Three Hundred and fifty employees during such period provided, however, that during the first Three Months from February 1st, 1922, it shall not be required to employ more than One Hundred and Seventy-five employees which force shall be gradually increased, so that at the end of said first Three Months period, at least Two Hundred and fifty employees as aforesaid, shall be then regularly employed at all times, strikes, acts of Providence and conditions beyond its control excepted.

FOURTH: The contract entered into under date of June 14, 1921 is to be cancelled and superseded by this contract, provided, however, that it shall not be considered cancelled and superseded until the present factor, shall have been enlarged and operated on a more extensive scale, as hereinbefore set forth in paragraph THREE.

IN WITNESS WHEREOF, said Brown Shoe Company and the said Mattoon Association of Commerce have, by their duly authorized officers, in this behalf, set their hands and seals this 14th day of December, A. D. 1921, IN DUPLICATE.

Mattoon Association of Commerce (SEAL)

By Thos F Wright (SEAL)
Its President

ATTEST:
L. T. Hancock
Secretary

Brown Shoe Co. (SEAL)

By Harry L. Towne (SEAL)
Its Vice President.

ATTEST:
H. C. Baldwin
Acting Secretary.

We hereby certify that there has been deposited in our Bank, the sum of Ten Thousand DOLLARS to meet the payments to the Brown Shoe Company, provided by the foregoing contract.

CENTRAL ILLINOIS TRUST AND SAVINGS BANK
MATTOON, ILLINOIS.

By W. J. Osborne
President.

ATTEST:
H. O. Packard
Cashier.

We hereby certify that there has been deposited in our Bank, the sum of Twenty-five hundred DOLLARS to meet the payments to the Brown Shoe Company, provided by the foregoing contract.

STATE TRUST AND SAVINGS BANK
MATTOON, ILLINOIS.

By Frank D. Mason
President.

ATTEST:

secured so that the sum shall be available to pay the cost of the factory buildings and the equipment thereof as the work progresses thereon, BROWN SHOE COMPANY, INC. shall proceed without delay to construct and complete the necessary factory buildings and to equip the same as herein contemplated, provided said payments shall not be called for until a certificate of the architect or person in charge of construction shall certify that materials or labor has been furnished of value equal to such payments asked for, and it shall have the same completed in the earliest practicable time; it being understood that TEN THOUSAND DOLLARS ($ 10,000.00) of the said ONE HUNDRED THOUSAND DOLLARS ($ 100,000.00) shall be paid to BROWN SHOE COMPANY, INC. when the contract or contracts for the building is or are signed by the contractors and the Company, and the remaining NINETY THOUSAND DOLLARS ($ 90,000.00) shall be paid in installments of TEN THOUSAND DOLLARS ($ 10,000.00), as requested by BROWN SHOE COMPANY, INC., to make payments for said buildings and the equipment thereof. It is further agreed that the total sum of ONE HUNDRED THOUSAND DOLLARS ($ 100,000.00) shall be available for the purpose of making final payments for the factory and the equipment thereof within NINETY (90) days from the date of this contract.

SEVENTH: It is understood between the parties hereto, that BROWN SHOE COMPANY, INC. shall in good faith continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit. It is further understood that the main factory building shall be not less than forty (40) feet by Two hundred and fifty (250) feet, three stories high. Also, that the amount paid out for labor shall be not less than ONE MILLION TWO HUNDRED AND FIFTY THOUSAND DOLLARS ($ 1,250,000.00) during the period of the first ten (10) years, provided an adequate supply of labor is obtainable.

It is understood that said Brown Shoe Company, Inc., will carry insurance sufficient in amount to cover the cost of said building or buildings, and in the event of the total or partial destruction of the factory buildings by

EXHIBIT 4-D
SHEET 2

fire or other casualties, the insurance money received by BROWN SHOE COMPANY, INC. shall be employed in the reconstruction or repair thereof without unnecessary delay.

EIGHTH: BROWN SHOE COMPANY, INC., shall, if it accepts this proposition, operate said plant continuously so long as it is practicable in the conduct of its business, for at least a period of TEN (10) years, but in the event BROWN SHOE COMPANY, INC. shall within said period of ten (10) years elect to discontinue the manufacture of shoes at Matteon for any cause, BROWN SHOE COMPANY, INC. shall in that event reconvey to the undersigned Citizens Committee, or their successors, to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interest may appear, the factory site and building free of all incumbrances.

But, it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which BROWN SHOE COMPANY, INC. has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only as long as necessary.

NINTH: We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

TENTH: We agree to arrange with the owner of the building you are now occupying for an extension of your present lease until the new factory building is completed and ready to move into, you agree to pay rental at the present rate.

EXHIBIT "5-E"
SHEET 1

THIS AGREEMENT MADE AND ENTERED INTO by and between the Chamber of Commerce of Union City, Tennessee, party of the first part, and the Brown Shoe Company of St. Louis, Missouri, Party of the second part, WITNESSETH:-

In consideration of the mutual promises and obligations of each party made to the other said parties have this day entered into the following agreement:-

First:-- The party of the first part agree and obligate themselves to make, execute and deliver within ten days from the date of this contract a warranty deed conveying to the party of the second part free and clear of all liens and encumbrances the following described property, situated in the town of Union City, 13th Civil District of Obion County, Tennessee, bounded and described as follows:-

> Bounded on the North by Chesthan Street; on the West by First Street; on the South by Gibbs Street; and on the East by the Mobile & Ohio Railroad Company's right of way, being the entire tract of land situated between said streets and said railroad property, and now belonging to R. L. Whipple.

Party of the First Part further agree that they will within 60 days after the erection of the factory building as hereinafter provided, construct and complete pavement and sidewalk along the

March 7, 19 8.

Brown Shoe Company,
Saint Louis,
Missouri.

Gentlemen:

The undersigned citizens of the City of Mattoon, Coles County, State of Illinois, in behalf of themselves and other citizens of said city whom they represent, make you the following proposition to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business in said City of Mattoon, namely:

FIRST: Within ten days after the signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed, free and clear of all liens and incumbrances, a suitable site, such as will be satisfactory to you, for the locating of the factory buildings to be erected by you.

etc., for the manufacture of shoes; said factory building or buildings to be erected upon the site selected.

FOURTH: We agree to pay all City, County and State taxes for a period of ten (10) years from the opening of the factory.

FIFTH: We agree to furnish free of charge to you, the necessary water for all purposes for a period of ten (10) years from the opening of the factory.

SIXTH: Upon the acceptance of this proposition and when the site has been selected and the deed to the property has been delivered to BROWN SHOE COMPANY, INC., and the ONE HUNDRED THOUSAND DOLLARS ($ 100,000.00) have been secured so that the sum shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon, BROWN SHOE COMPANY, INC. shall proceed without delay to construct and complete the necessary factory buildings and to equip the same as herein contemplated, provided said payments shall not be called for until a certificate of the architect or person in charge of construction shall certify that materials or labor has been furnished of value equal to such payments asked for, and it shall have

Cashier.

We hereby certify that there has been deposited in our Bank, the sum of Twenty five hundred DOLLARS to meet the payments to the Brown Shoe Company, provided by the foregoing contract.

STATE TRUST AND SAVINGS BANK
MATTOON, ILLINOIS.

By Frank J Mooney
President.

ATTEST:

J B Crane
Cashier.

We hereby certify that there has been deposited in our Bank, the sum of Fifty five hundred DOLLARS to meet the payments to the Brown Shoe Company, provided by the foregoing contract.

THE NATIONAL BANK OF MATTOON,
MATTOON, ILLINOIS.

By Frank Crane
President

ATTEST: E W Vallmer
Cashier.

7-a

FIRST: Within ten days after the signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed, free and clear of all liens and incumbrances, a suitable site, such as will be satisfactory to you, for the locating of the factory buildings to be erected by you.

SECOND: We will supply the site so selected with the necessary water mains of both systems to bring into the premises the necessary water for use in the factory for factory purposes, for adequate fire protection including sprinkler system and for the needs of the employees employed therein.

We will also connect said premises with the city sewers for all practicable purposes.

We will connect said premises with the gas mains of the City.

We will connect said premises with electric power and light wires.

We will construct and complete pavement and sidewalks to the factory buildings and in front of the same, so as to make the factory site accessible from the different points of the compass, to be completed by the time the proposed factory buildings are erected.

We will construct and complete switch and sidetracks, suitable to BROWN SHOE COMPANY, in accordance with the requirements of its business, connecting the factory buildings with the Illinois Central Railroad.

THIRD: We agree to pay you or place at your disposal the sum of ONE HUNDRED THOUSAND DOLLARS ($ 100,000.00) in cash, to be used for the payment of suitable factory building or buildings and the equipment thereof, including a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevator and the necessary machinery,

EXHIBIT 4-D
SHEET 1

present lease until the new factory building is completed and ready to move into, you agree to pay rental at the present rate.

BROWN SHOE COMPANY, INC., hereby accepts the foregoing proposition and agrees to be bound by the terms thereof.

BROWN SHOE COMPANY, INC.

BY _____

Vice President.

ATTEST:

_____

Secretary.

EXHIBIT 4-D
SHEET 3

themselves to make, execute and deliver within ten days from the date of this contract a warranty deed conveying to the party of the second part free and clear of all liens and encumbrances the following described property, situated in the town of Union City, 13th Civil District of Obion County, Tennessee, bounded and described as follows:-

Bounded on the North by Chesthan Street; on the West by First Street; on the South by Gibbon Street; and on the East by the Mobile & Ohio Railroad Company's right of way, being the entire tract of land situated between said streets and said railroad property, and now belonging to R. L. Whipple.

Party of the First Part further agree that they will within 60 days after the erection of the factory building as hereinafter provided, construct and complete a pavement and sidewalk along the entire length of the west side of said tract of land from Gibbon Street to Chesthan Street, and also along the entire width of said tract along the South side thereof on Gibbon Street. Party of the First Part further binds itself to connect said tract of land with an adequate sewerage system, disposing of said sewerage in a sanitary, healthful and practical manner and so as not to endanger the health of the employees of said factory or those living in the locality of said tract of land, and said Party of the First Part further binds itself to connect said tract of land with a six inch water main of the Union City Water Works System, or with two four inch water mains of said system, in the event a six inch water main is not available.

11-a

SECOND:-- Party of the first part further agree and obligate themselves to supply the foregoing described site or town lot with the necessary water mains and connect said premises with the sewerage and electric wires owned and operated by the town of Union City, and they further agree to construct and complete concrete sidewalks to the front of the factory building hereinafter provided for, so as to make the factory site and building accessible from the different points of the compass, and to be completed within sixty days after the erection of the factory building as hereinafter provided, and the party of the first part further binds and obligates itself to the party of the second part to construct and complete switch and side tracks suitable to the Brown Shoe Company and necessary in the operation of said factory connecting same with the Mobile & Ohio Railroad.

THIRD:-- The party of the first part further binds and obligates itself to place at the disposal of the party of the second part in the manner hereinafter provided the sum of One Hundred Thousand Dollars ($100,000.00), which amount the party of the

FIFTH:-- The Party of the Second Part bind and obligate themselves, when the deed to the real estate hereinbefore described has been delivered to Party of the Second Part, and the One Hundred Thousand Dollars ($100,000.00) is available to it for said factory building and equipment, to proceed without delay to construct and complete the necessary factory building and to equip the same as herein contemplated, provided said payments on said one hundred thousand dollars shall not be called for until a certificate of labor and material has been furnished Party of the First part showing an amount of labor equal to the payments asked for, and said buildings shall be completed by the Party of the Second Part at the earliest practicable time; it being further understood that Ten Thousand Dollars of the said One Hundred Thousand Dollars shall be paid by Party of the First Part to the Party of the Second Part when the contract or contracts for the buildings is or are signed by the contractors and said Party of the Second Part, and the remaining ninety thousand dollars shall be paid by the Party of the First Part in installments of ten thousand dollars as requested by the Brown Shoe Company, to make payments of said buildings and the equipment thereof, it being agreed and understood that the total sum of one hundred thousand dollars shall be available and payable by party of the

-4-

during the period of the first ten years of the operation of said factory, provided an adequate supply of labor is obtainable.

Party of the Second Part farther binds and obligates itself to carry insurance on said factory building and equipment in sufficient amount to cover the cost of the same, and in the event of the total or partial destruction of the factory building or equipment by fire or other casualties the insurance money received by the Brown Shoe Company shall be employed in the reconstruction or repair thereof without unnecessary delay.

SEVENTH:-- The party of the Second Part farther binds and obligates itself to operate said plant continuously as long as it is practicable in the conduct of its business for at least a period of ten years; but in the event party of the Second Part shall within said period of ten years elect to discontinue, or fail to continue the manufacture of shoes in said factory building in Union City for any cause, or shall otherwise in any manner fail to fully comply with the obligations herein assumed by the party of the Second Part, said party of the Second Part shall in such event reconvey to the party of the First Part to be held in trust by them for the citizens contributing to the bonus fund for the establish-

It is distinctly understood and agreed by the parties hereto that a shut-down in the operation of the factory herein contemplated rendered necessary either by fire, war or other casualties, or by causes over which party of the second part has no control, such as parties, epidemics or trade or labor conditions shall not be considered a discontinuance of said plant, but such shut-down shall continue only so long as necessary, and the period covered by such shut-down on account of any of the above causes shall not be considered in computing the ten year period for the operation of said plant as hereinabove provided.

EIGHTH:-- Party of the First Part hereby pledges to Party of the Second Part its loyal support and the support of the business men and citizens of Union City, Tennessee, in making the factory a success, and agrees with the Party of the Second Part to co-operate with it in any manner possible in the carrying out of said successful conduct of said factory.

NINTH:-- Party of the First Part binds and obligates itself to furnish to the Party of the Second Part rent free, for temporary use until the factory is ready for occupancy, a room to be used for educating girls in stitching uppers, party of the Second Part to pay for the cost of power and the Party of the First Part to pay for bringing the wiring to said room or building.

Salem, Illinois, January 3, 1925.

Brown Shoe Company, Inc.,
St. Louis, Missouri.

Gentlemen:

The undersigned citizens of the City of Salem, Marion County, State of Illinois in behalf of themselves and other citizens of said city whom they represent, make you the following proposition to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business in said City of Salem, namely:

1st. Within ten days after signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed free and clear of all liens and incumbrances, a suitable site, such as will be satisfactory to you, for the locating of the factory buildings to be erected by you.

2nd. We will supply the site so selected with the necessary water mains to bring into the premises the city water for use in the factory or factories for factory purposes and for the needs of the employees employed therein.

We will also connect said premises with the city sewers for all practicable purposes.

We will connect said premises with electric power wires.

We will construct and complete pavement and sidewalks to the factory buildings and in front of same, so as to make the factory site accessible from the different points of the compass, (to be completed within sixty days after proposed factory buildings have been erected.)

We will construct and complete switch and sidetracks, suitable to Brown Shoe Company in accordance with the requirements of its business, connecting the factory buildings with the adjacent steam railroad.

3rd. We agree to pay you or place at your disposal, the sum of one hundred thousand($100,000) dollars in cash, to be used for the payment of suitable factory building or buildings and the equipment thereof including power and lighting plants, a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevators and the necessary machinery, etc., for the manufacture of shoes; said factory building or buildings to be erected upon the site selected.

the total or partial destruction of the factory buildings by fire or other casualties, the insurance money received by Brown Shoe Company, Inc., shall be employed in the reconstruction or repair thereof without unnecessary delay.

7th. Brown Shoe Company, Inc., shall, if it accepts this proposition, operate said plant continuously so long as it is practicable in the conduct of its business for at least a period of ten years: but in the event Brown Shoe Company, Inc., shall within said period of ten (10) years elect to discontinue the manufacture of shoes at Salem, for any cause, Brown Shoe Company, Inc., shall in that event reconvey to the undersigned Citizens Committee, or their successors, to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interests may appear, the factory site and buildings free of all incumbrances.

But it is distinctly understood that a shut-down rendered necessary either by fire, war, or other casualties, or by causes over which Brown Shoe Company, Inc., has no control, such as epmics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only so long as necessary.

8th. We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

9th. We will furnish you rent free, as soon as you are ready for it, for temporary use until the factory building is ready for occupancy, a room to be used for educating girls in stitching uppers, you to pay for cost of power, we to pay for bringing wiring to said room or building.

provided suitable buildings can be procured,

C L McMacken W B Roberts Salem Chamber of Commerce
C W Virgell C P Ratzburg By John Clinton President
Chas E Houck O A Sawtelle John L Kaye
John C Martin Chas Meyers Frank Schmeltzly
W E McAuton W B Pendleton Fred Anderson
Alex D Mellis W O Jenkins Secy. Arthur J. Morrell. Ed Bauman Jansen

so as to make the factory site and building accessible from the different points of the compass, and to be completed within sixty days after the erection of the factory building as hereinafter provided, and the party of the first part further binds and obligates itself to the party of the second part to construct and complete switch and side tracks suitable to the Brown Shoe Company and necessary in the operation of said factory connecting same with the Mobile & Ohio Railroad.

THIRD:--The party of the first part further binds and obligates itself to place at the disposal of the party of the second part in the manner hereinafter provided the sum of One Hundred Thousand Dollars ($100,000.00), which amount the party of the second part obligates itself to use for the payment of the construction of a suitable factory building or buildings and the equipment thereof, including power and lighting plants, fire extinguisher system, fire escapes, wiring, heating, plumbing and elevators, said factory building to be located upon the lot of land hereinabove described, and to be of the dimensions and construction as hereinafter provided.

FOURTH;--The party of the first part further binds and obligates itself, and each and every member of the Chamber of Commerce of Union City, to use its influence and its best efforts in having all city taxes and city license fees, including water coming to the Corporation of Union City, remitted by said Corporation of Union City for a period of ten years.

of about equal to the payments above set, said buildings shall be completed by the Party of the Second Part at the earliest practicable time; it being further understood that Ten Thousand Dollars of the said One Hundred Thousand Dollars shall be paid by Party of the First Part to the Party of the Second Part when the contract or contracts for the buildings is or are signed by the contractors and said Party of the Second Part, and the remaining ninety thousand dollars shall be paid by the Party of the First Part in installments of ten thousand dollars as requested by the Brown Shoe Company, to make payments of said buildings and the equipment thereof, it being agreed and understood that the total sum of one hundred thousand dollars shall be available and payable by party of the First Part to Party of the Second Part for the purpose of making final payments for the factory and equipment thereof within one hundred and twenty (120) days from the date of this contract.

SIXTH:-- Party of the Second Part further binds and obligates itself to continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit, and Party of the Second Part further agree that the main factory building shall be not less than forty-five (45) feet wide by two hundred and fifty (250) feet in length, built of brick, three stories high and shall employ six (600) hundred employees when operated to its full capacity, and party of the Second Part further binds and obligates itself that it shall pay out for labor not less than one million, two hundred and fifty thousand dollars

repair thereof without unnecessary delay.

SEVENTH:-- The party of the second part further binds and obligates itself to operate said plant continuously as long as it is practicable in the conduct of its business for at least a period of ten years; but in the event party of the second part shall within said period of ten years elect to discontinue, or fail to continue the manufacture of shoes in said factory building in Union City for any cause, or shall otherwise in any manner fail to fully comply with the obligations herein assumed by the party of the second part, said party of the second part shall in such event reconvey to the party of the first part to be held in trust by them for the citizens contributing to the bonus fund for the establishment of said plant, as their interest may appear, the factory site and building and equipment, except shoe-making machinery, free of all encumbrances, and the party of the second part further agree that in order to guarantee to the party of the first part that the above provision will be carried out they will have attached to each policy of insurance covering the factory building and equipment, either fire, tornado, boiler explosion or any other policy covering the real estate and equipment, a loss payable clause to the Chamber of Commerce of Union City as its interest might appear.

EIGHTH:-- Party of the First Part hereby pledges to Party of the Second Part its loyal support and the support of the business men and citizens of Union City, Tennessee, in making the factory a success, and agrees with the Party of the Second Part to co-operate with it in any manner possible in the carrying out of said successful conduct of said factory.

NINTH:-- Party of the First Part binds and obligates itself to furnish to the party of the Second Part rent free, for temporary use until the factory is ready for occupandy, a room to be used for educating girls in stitching uppers, party of the Second Part to pay for the cost of power and the Party of the First Part to pay for bringing the wiring to said room or building.

WITNESS OUR SIGNATURES, this November 29th, 1922.

Chamber of Commerce of Union City,

By _____
President,

By _____
Secretary,

By _____
Treasurer

Approved:

_____ _____

_____ _____

_____ _____

Board of Directors Chamber of Commerce of Union City.

Brown Shoe Company

By _____

We will construct and complete pavement and sidewalks to the factory buildings and in front of same, so as to make the factory site accessible from the different points of the compass, (to be completed within sixty days after proposed factory buildings have been erected.)

We will construct and complete switch and sidetracks, suitable to Brown Shoe Company in accordance with the requirements of its business, connecting the factory buildings with the adjacent steam railroad.

3rd. We agree to pay you or place at your disposal, the sum of one hundred thousand($100,000) dollars in cash, to be used for the payment of suitable factory building or buildings and the equipment thereof including power and lighting plants, a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevators and the necessary machinery, etc., for the manufacture of shoes; said factory building or buildings to be erected upon the site selected.

4th. We agree to have all taxes and license fees, including water, properly coming to the City of Salem rebated by said City for a period of ten years.

5th. Upon the acceptance of this proposition, and when the site has been selected and the deed to the property has been delivered to Brown Shoe Company, Inc., and the one hundred thousand ($100,000) dollars have been secured so that the sum shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon, Brown Shoe Company, Inc., shall proceed without delay to construct and complete the necessary factory buildings [redacted] to equi the same as herein contemplated, and it shall have the same completed in the earliest practicable time; it being understood that ten thousand($10,000) dollars of the said one hundred thousand ($100,000) dollars shall be paid to Brown Shoe Company, Inc., when the contract or contracts for the buildings is or are signed by the contractors and the Company, and the remaining ninety thousand ($90,000) dollars shall be paid in installments of ten t ousand($10,000) dollars, as requested by Brown Shoe Company, Inc., to make payments for said buildings and the equipment thereof. It is further agreed that the total sum of one hundred thousand ($100,000) dollars shall be available for the purpose of making final payments for the factory and the equipment thereof within [redacted] from the date of this contract.
(Final payment to be made in no event until six months building is completed)

6th. It is understood between the parties hereto that Brown Shoe Company, Inc., shall in good faith continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit. It is further understood that the main factory building shall be not less than 40 feet X 250 feet, three stories high, and that the amount paid our for labor shall be not less than one million two hundred fifty thousand ($1,250,000) dollars during the period of the first ten years, provided a suitable supply of labor is obtainable.

It is understood that said Brown Shoe Company, Inc., will carry insurance sufficient in amount to cover the cost of said building or buildings, and in the event of

and steam not less than 60' x 80' three stories high

EXHIBIT 6-F
SHEET 1

temporary use until the factory building is ready for occupancy, a room to be used for educating girls in stitching uppers, you to pay for cost of power, we to pay for bringing wiring to said room or building.

C L McMackin — W B Roberts — Salem Chamber of Commerce
C W Durrell — C P Ratzburg — By John Clouston President
Chas E Hurll — O A Daniels — John L Rogers
John Clouston — Chas Meyers — Frank Schwartz
W E M artin — W B Purdue — J J Martin
Alex D Mennix — H O Jenkins — Allen Andrews
F C Cameron — Arelius J Morrell — E H Baumgarten
L F Killough — Swasey Bro & Co — E B Riddle M D
W H Berman — J M Gaskin — H C Moore
A C Stewart — H Erickson — J L Smith & Son
W O C Liddy — H A Sommer — J B Stonecipher
F Safford — Ray Mynard — Pat Welch
Herbert Kaufman — Chas A Galt — C O Long
John L Kragt — Frank C Merrill — Lafayette
IN DUPLICATE — C R Lamont

Brown Shoe Company, Inc., hereby accepts the foregoing proposition and agrees to be bound by the terms thereof.

BROWN SHOE COMPANY, Inc.

[signature]

Vice President.

ATTEST: [signature]

Secretary.

EXHIBIT G-F
SHEET 2

67

EXHIBIT "7-G"

3

OFFICE: 119A W. MAIN

TELEPHONE 61

SALEM CHAMBER OF COMMERCE

SALEM, ILLINOIS

OFFICERS

C. A. PORTER, President
W. O. RODDY, Vice-President
F. B. STORMENT, Treasurer
JOHN L. KAGY, Secretary

DIRECTORS

F. B. YOUNG — F. B. STORMENT
O. J. McMACKIN — B. E. MARTIN
BENJ. M. SMITH — C. A. PORTER
JOHN C. MARTIN — F. A. DIETRICH
W. O. RODDY

SALEM

Population, 4,500

Municipal Light and Water Plants

78 Miles from St. Louis and 284 Miles from Chicago, in the Heart of the Dairy, Poultry and Fruit Growing District

Railroads—
C. & E. I. R. R.
B. & O. S. W. R. R.
M. & I. R. R.

On Midland Trail and Other Main Auto Roads

Served by Several Auto Bus and Truck Freight Lines

Fine Residential Districts

Two Active Building and Loan Associations

One Public Park

Fine Country Club With 9-Hole Golf Course

Two Movie Theatres

Four Grade Schools—One High School with Large Gym

Salem, Illinois, October 20, 1927

E. H. McCarthy Vice President,
Brown Shoe Company,
St. Louis, Mo.

Dear Sir:

Answering your telegram of the 19th, the Salem Chamber of Commerce is now ready to enter into a contract with you along the lines discussed when in your office recently, with reference to the construction of an addition 40 x 100 feet, three stories high, on the west end of your present building here.

We have made a canvass of our business people and have the $25,000.00 asked fully subscribed.

At a meeting of the directors of our association this afternoon, I was authorized to offer you $25,000.00 for the erection of such addition, on the following terms:

$10,000.00	payable as the work progresses
5,000.00	May 1st, 1928
5,000.00	Nov. 1st, 1928
5,000.00	May 1st, 1929

EXHIBIT "8-H"
SHEET 1

(99-a)

9

"THE STORE THAT CLOTHES AND FEEDS THE WHOLE FAMILY"

L. W. CLINE & CO.

WEST SIDE SQUARE, 415-417 NORTH STATE STREET

LITCHFIELD, ILL. May 23rd 1925

Mr. E. R. McCarthy, Vice President,
Brown Shoe Company, Inc.,
St. Louis, Missouri.

Dear Mr. McCarthy:

It gives me much pleasure to report that the campaign put on by our Chamber of Commerce to raise a fund of $ 25,000 as an inducement to your Company to build an addition to your Litchfield Plant, has been a complete success.

We therefore tender to you this sum, in consideration of a cancellation of the clauses in the old contract providing for a switch from the Big Four Railroad and for paving the street on the south side of your Plant, and further, in consideration of the erection of a new addition, 90 feet by 39 feet, 4 stories high, which, we understand, will increase your capacity approximately thirty per cent, and will mean an increase in the annual pay roll of the plant of around $150,000.

"THE STORE THAT CLOTHES AND FEEDS THE WHOLE FAMILY"

L. W. CLINE & CO.

WEST SIDE SQUARE, 415-417 NORTH STATE STREET

LITCHFIELD, ILL. 192

We therefore feel that this proviso should be incorporated in the new contract, that is, for the remaining part of the ten year period.

Yours very truly,

L. W. Cline

COMMITTEE CHAIRMAN.

4

Vincennes, Indiana, December , 1925.

Brown Shoe Company, Inc.,
St. Louis, Missouri.

Gentlemen:-

The undersigned citizens of the City of Vincennes, Knox County, State of Indiana, in behalf of themselves and other citizens of said city whom they represent, make you the following proposition to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business in said City of Vincennes, namely:

1st. Within ten days after signing of this agreement, we will furnish to you and within ninety days will deed to you absolutely by a good warranty deed free and clear of all liens and incumbrances a suitable site, such as will be satisfactory to you, for the locating of the factory buildings to be erected by you.

2nd. We will supply the site so selected with the necessary water mains to bring into the premises the city water for use in the factory for factory purposes and for the needs of the employees employed therein.

We will also connect said premises with the city sewers for all practicable purposes.

We will connect said premises with the gas mains of the city.

We will connect said premises with electric power wires.

We will construct and complete pavement and sidewalks to the factory buildings and in front of the same, so as to make the factory site accessible from the different points of the compass, and to be completed within sixty days after proposed factory buildings have been erected.

We will construct and complete switch and sidetracks, suitable to Brown Shoe Company, in accordance with the requirements of its business, connecting the

We will connect said premises with electric power wires.

We will construct and complete pavement and sidewalks to the factory buildings and in front of the same, so as to make the factory site accessible from the different points of the compass, and to be completed within sixty days after proposed factory buildings have been erected.

We will construct and complete switch and sidetracks, suitable to Brown Shoe Company, in accordance with the requirements of its business, connecting the factory buildings with B. & O. Railroads.

3rd. We agree to pay you or place at your disposal the sum of one hundred thousand ($100,000) dollars in cash, to be used for the payment of suitable factory building or buildings and the equipment thereof including power and lighting plants, a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevators and the necessary machinery, etc., for the manufacture of shoes: said factory building or buildings to be erected upon the site selected.

4th. We agree to have all taxes and license fees, including water, properly coming to the City of Vincennes rebated by said City for a period of ten years.

5th. Upon the acceptance of this proposition and when the site has been selected and the deed to the property has been delivered to Brown Shoe Company, Inc., and the one hundred thousand ($100,000) dollars have been secured so that the sum shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon, Brown Shoe Company, Inc., shall proceed without delay to construct and complete the necessary factory buildings and to equip the same as herein contemplated, (provided said payments shall not be called for until a certificate of the architect or person in charge of construction shall certify that materials or labor has been furnished of value equal to such payments asked for,) and it shall have the same completed in the earliest practicable time: it being understood that ten thousand ($10,000) dollars of the said one hundred thousand ($100,00) dollars shall be paid to Brown Shoe Company, Inc., when the contract or contracts for the building is or are signed by the contractors and the Company, and the remaining ninety thousand ($90,000) dollars shall be paid in installments of ten thousand ($10,000) dollars, as requested by Brown Shoe Company, Inc., to make payments for said buildings and the equipment thereof. It is further agreed that the total sum of one hundred thousand ($100,000) dollars shall be available for the purpose of making final payments for the factory and the equipment thereof within one hundred and twenty (120) days from the date of this contract.

EXHIBIT 9-1
SHEET 1

6th. It is understood between the parties hereto that Brown Shoe Company, Inc., shall in good faith continuously operate in the ordinary course of business, said factory to as large a capacity as conditions will permit. It is further understood that the main factory building shall be not less than 40 feet X 250 feet, three stories high. Also, that the amount paid out for labor shall be not less than one million two hundred fifty thousand ($1,250,000) dollars during the period of the first ten years, provided and adequate supply of labor is obtainable.

It is understood that said Brown Shoe Company, Inc., will carry insurance sufficient in amount to cover the cost of said building or buildings, and in the event of the total or partial destruction of the factory buildings by fire or other casualties the insurance money received by Brown Shoe Company, Inc., shall be employed in the reconstruction or repair thereof without unnecessary delay.

7th. Brown Shoe Company, Inc., shall, if it accepts this proposition, operate said plant continuously so long as it is practicable in the conduct of its business for at least a period of ten years: but in the event Brown Shoe Company, Inc., shall within said period of ten (10) years elect to discontinue the manufacture of shoes at Vincennes for any cause, Brown Shoe Company, Inc., shall in that event reconvey to the undersigned Citizens Committee, or their successors, to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interests may appear, the factory site and buildings and equipments free of all incumbrances.

But it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc., has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only so long as necessary.

8th. We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

9th. If needed by you, we will furnish you rent free, for temporary use until the factory building is ready for occupancy, a room to be used for educating girls in stitching uppers, you to pay for cost of power, we to pay for bringing wiring to said room or building.

Fruit Growing District

Railroads—
C. & E. I. R. R.
B. & O. S. W. R. R.
M. & I. R. R.

On Midland Trail and Other Main Auto Roads

Served by Several Auto Bus and Truck Freight Lines

Fine Residential Districts

Two Active Building and Loan Associations

One Public Park

Fine Country Club With 9-Hole Golf Course

Two Movie Theatres

Four Grade Schools—One High School with Large Gym.

Many Fine Churches.

Up-to-Date Traffic Bureau

Several Prosperous Industries

AND WE WANT MORE

Active Chamber of Commerce At Your Service

WRITE US!

Dear Sir:

Answering your telegram of the 19th, the Salem Chamber of Commerce is now ready to enter into a contract with you along the lines discussed when in your office recently, with reference to the construction of an addition 40 x 100 feet, three stories high, on the west end of your present building here.

We have made a canvass of our business people and have the $25,000.00 asked fully subscribed.

At a meeting of the directors of our association this afternoon, I was authorized to offer you $25,000.00 for the erection of such addition, on the following terms:

$10,000.00	payable as the work progresses
5,000.00	May 1st, 1928
5,000.00	Nov. 1st, 1928
5,000.00	May 1st, 1929

The above terms of payment are not just as discussed with you, but we found it necessary, in getting subscriptions, to offer more liberal terms than on the former canvass. Should the payments come in quicker than contracted, we have no objection to paying them over to you.

We are ready to enter into formal agreement with you at any time it suits your convenience.

Yours very truly,

C. A. Potter

President.

Accepted:

Brown Shoe Company

By. E. [illegible] V. Pres.

October 24th, 1927

(12-A)

It gives me much pleasure to report that the campaign put on by our Chamber of Commerce to raise a fund of $ 25,000 as an inducement to your Company to build an addition to your Litchfield Plant, has been a complete success.

We therefore tender to you this sum, in consideration of a cancellation of the clauses in the old contract providing for a switch from the Big Four Railroad and for paving the street on the south side of your Plant, and further, in consideration of the erection of a new addition, 90 feet by 39 feet, 4 stories high, which, we understand, will increase your capacity approximately thirty per cent, and will mean an increase in the annual pay roll of the plant of around $150,000.

The Committee in taking subscriptions from the citizens, felt it wise to spread the payments over a six-months period, one-third of the amounts subscribed being payable on July 1st, October 1st and January 1st, respectively. As you may know, Litchfield has recently raised $300,000 for a new Water Works Plant, and as this was somewhat of a hardship on our people, the Committe thought that subscriptions to the Brown Shoe Company fund could be raised more easily if a little time were given to the subscribers. We therefore propose to make the payments to you as follows:

$ 8,500 on July 1st;
$ 8,500 on October 1st;
$ 8,000 on January 1st.

In the old contract, there was an agreement that we would see that city taxes be rebated for a period of ten years from the erection of the plant.

has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only so long as necessary.

8th. We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

9th. If needed by you, we will furnish you rent free, for temporary use until the factory building is ready for occupancy, a room to be used for educating girls in stitching uppers, you to pay for cost of power, we to pay for bringing wiring to said room or building.

Vincennes Chamber of Commerce

Vincennes, Indiana

B. F. Nesbitt President

Edgar N Hausman V P

IN DUPLICATE.

Brown Shoe Company, Inc., hereby accepts the foregoing proposition and agrees to be bound by the terms thereof.

December 15. 1925

BROWN SHOE COMPANY, INC.

Vice-President.

ATTEST:

Secretary.

EXHIBIT 9-1
SHEET 2

A G R E E M E N T.

WHEREAS, negotiations have been entered into between the Brown Shoe Company, a New York corporation, and the Board of Trustees of the Moberly Industrial Foundation, for and in behalf of the citizens of Moberly, Missouri, and other persons, subscribers to the Moberly Industrial Expansion Fund, and arrangements have been made for the establishment of an addition to the shoe factory of said company, now located in Moberly, Missouri;

NOW THEREFORE, it is agreed by and between the said company and said subscribers, represented by said Board, as follows:

For and in consideration of the sum of Seventy-Five Thousand Dollars ($75,000.00), to be paid to said company by said board for and in behalf of said subscribers, said company does hereby covenant and agree to build, establish and operate an addition to its shoe factory now located in Moberly, Missouri, situated on Carpenter Street in said City, which addition is to contain at least forty-thousand (40,000) square feet of floor space, same to be built and completed according to the plans submitted by said company to representatives of said board on the 5th day of July, 1927, the estimated cost to be approximately One Hundred Thousand Dollars ($100,000.00), and to be constructed at the expense of said company.

the employees employed therein and mentioned in this contract has reference to employees to be employed in said addition, same being in addition to the number now employed in the factory operated in Moberly, Missouri.

It is understood that a shut-down rendered necessary either by fire, war, or other casualties, or by causes over which Brown Shoe Company, Inc. has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only so long as necessary.

Said company agrees that it will begin the construction and erection of said addition upon the signing of this agreement and will proceed therewith with all convenience speed and complete same as soon as practicable, and will begin to operate said additional factory not later than six months from the date of this agreement and will operate same at as near full capacity as possible.

Should said company fail or refuse to carry out its part of this contract, then immediately upon such default and failure and refusal on its part, it shall pay back and return to said board the sum of said, to-wit, Seventy-five Thousand Dollars ($75,000.00)

porate seal to be hereunto affixed and said board has caused same to be signed by its members this 10 day of Dec. 1927.

BROWN SHOE COMPANY

ATTEST:

Secretary.

BY:

Vice President.

MOLLY INDUSTRIAL FOUNDATION

BY:

The undersigned, SULLIVAN COMMUNITY CLUB of Sullivan, Illinois, by its proper officers, hereby makes the following proposition and agreement, and which agreement is guaranteed by the signature of certain other citizens of the City of Sullivan, Illinois who signed both in behalf of themselves and other citizens of said City of Sullivan whom they represent, make you the following proposition to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business in said City of Sullivan, Illinois, namely:

FIRST: Within ten days after the signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed, free and clear of all liens and incumbrances, a suitable site, such as will be satisfactory to you, for the locating of the factory buildings to be erected by you.

SECOND: We will supply the site so selected with the necessary water mains of our system to bring into the premises the necessary water for use in the factory for factory purposes, for adequate fire protection including sprinkler system

2.

87

We will construct and complete switch and sidetracks, suitable to Brown Shoe Company, in accordance with the requirements of its business, connecting the factory buildings with the Illinois Central Railroad, it being understood however, that the track outside of the grounds of the Brown Shoe Company may be used for team switch so as not to interfere in any manner with the business of the Brown Shoe Company.

THIRD: We agree to pay you or place at your disposal the sum of One Hundred Thousand Dollars ($100,000.00) in cash, to be used for the payment of suitable factory building or buildings and the equipment thereof including a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevator and the necessary machinery, etc., for the manufacture of shoes; said factory building or buildings to be erected upon the site selected.

FOURTH: We agree to pay all city, county and state taxes for a period of ten years from the opening of the factory.

FIFTH: We agree to furnish free of charge to you the necessary water for all purposes for a period of ten years from the opening of the factory.

SIXTH: Upon the acceptance of this proposition and when

3.

ave the same completed in the earliest practicable time; it
eing understood that Ten Thousand ($10,000.00) Dollars of the
id One Hundred Thousand ($100,000.00) Dollars shall be paid
o Brown Shoe Company, Inc., when the contract or contracts
or the building is or are signed by the contractors and the
Company, and the remaining Ninety Thousand ($90,000.00) Dollars
shall be paid in installments of Ten Thousand Dollars ($10,000.00)
the said installments to be paid at intervals of thirty days
from the date of signing of said contract, it being understood
that the plan of payment of said One Hundred Thousand ($100,000.00)
Dollars is as follows: Ten Thousand Dollars ($10,000.00) to
be paid as soon to the Brown Shoe Company upon the signing of
the contract for said building, and Ten Thousand Dollars ($10,000.00
each month thereafter for a period of nine months. ~~It is~~
~~especially provided however, that on any part of said One~~
~~Hundred Thousand ($100,000.00) Dollars not paid within ninety~~
~~(90) days from the date of signing of the contract for said~~
~~building, that we will allow to the Brown Shoe Company six per~~
~~cent interest from such date until fully paid, with full~~

board for and in behalf of said subscribers, said company does hereby covenant and agree to build, establish and operate an addition to its shoe factory now located in Moberly, Missouri, situated on Carpenter Street in said City, which addition is to contain at least forty-thousand (40,000) square feet of floor space, same to be built and completed according to the plans submitted by said company to representatives of said board on the 5th day of July, 1927, the estimated cost to be approximately One Hundred Thousand Dollars ($100,000.00), and to be constructed at the expense of said company. Said company agrees to use and occupy said addition for the purpose of manufacturing shoes and footwear, and to install efficient, proper and adequate machinery and equipment therein for property manufacturing shoes and footwear and to do and conduct therein a general shoe manufacturing business, affording, as nearly as possible, all year employment to those employed therein and agrees that it will operate and conduct said business in said addition for a period of ten (10) years from the beginning of the operation of said additional plant, and that it will pay out to its employees employed in said addition, in wages, the sum of at least Seven Hundred Fifty Thousand Dollars ($750,000.00) in the aggregate during said ten (10) year period; it being understood and agreed that the amount so paid shall be in addition to the amount normally paid in wages to its employees employed in its factory, now operated in Moberly, Missouri, and that

(1).

EXHIBIT "10-"
SHEET 1

Said company agrees that it will begin the construction and erection of said addition upon the signing of this agreement and will proceed therewith with all convenience speed and complete same as soon as practicable, and will begin to operate said additional factory not later than six months from the date of this agreement and will operate same at as near full capacity as possible.

Should said company fail or refuse to carry out its part of this contract, then immediately upon such default and failure and refusal on its part, it shall pay back and return to said board the sum so paid, to-wit, Seventy-Five Thousand Dollars ($75,000.00); and in case of the non-existence of said board, then to such trustees as the Circuit Court of Randolph County, Missouri, at Moberly, may appoint as successors, such successors to use said money for the purposes mentioned in the subscription agreement signed by said subscribers in said Industrial Expansion Campaign.

Said Seventy-Five Thousand Dollars ($75,000.00) shall be paid as follows:

Ten Thousand Dollars ($10,000.00) on the execution of this contract, and the balance in installments of Ten Thousand Dollars ($10,000.00), each to be paid as the building progresses, to be determined by the amount of labor and material which has been furnished in said building.

IN WITNESS WHEREOF, the said company has caused this agreement to be signed by its duly authorized officers and its cor-

MOVERLY INDUSTRIAL FOUNDATION

BY: _____

_____

_____

_____

_____

_____

Trustees.

EXHIBIT "10"
SHEET 3

to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business in said City of Sullivan, Illinois, namely:

FIRST: Within ten days after the signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed, free and clear of all liens and incumbrances, a suitable site, such as will be satisfactory to you, for the locating of the factory buildings to be erected by you.

SECOND: We will supply the site so selected with the necessary water mains of our system to bring into the premises the necessary water for use in the factory for factory purposes, for adequate fire protection including sprinkler system and for the needs of the employees employed therein.

We will also connect said premises with a proper drainage outlet for all practical purposes.

We will connect said premises with electric power and light wires.

We will construct and complete pavement and side walks in front of the factory site, unless pavement is already in at the site selected, so as to make the factory site accessible, it being understood that any pavement and side walks inside of the grounds to be turned to the Brown Shoe Company will be constructed by the Brown Shoe Company.

buildings and the equipment thereof including a good and sufficient fire extinguisher system, fire escapes, wiring, heating, plumbing, elevator and the necessary machinery, etc., for the manufacture of shoes; said factory building or buildings to be erected upon the site selected.

FOURTH: We agree to pay all city, county and state taxes for a period of ten years from the opening of the factory.

FIFTH: We agree to furnish free of charge to you the necessary water for all purposes for a period of ten years from the opening of the factory.

SIXTH: Upon the acceptance of this proposition and when the site has been selected and the deed to the property has been delivered to Brown Shoe Company, Inc., and the One Hundred Thousand ($100,000.00) Dollars have been secured so that the sum shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon, Brown Shoe Company, Inc., shall proceed without delay to construct and complete the necessary factory buildings and to equip the same as herein contemplated, provided said payments shall not be called for until a certificate of the architect or person in charge of construction shall certify that materials or labor has been furnished of value equal to such payments asked for, and it shall

the said instalments to be paid at intervals of thirty days from the date of signing of said contract, it being understood that the plan of payment of said One Hundred Thousand ($100,000.00) Dollars is as follows: Ten Thousand Dollars ($10,000.00) to be paid as soon to the Brown Shoe Company upon the signing of the contract for said building, and Ten Thousand Dollars ($10,000.00) each month thereafter for a period of nine months. ~~It is especially provided however, that on any part of said One Hundred Thousand ($100,000.00) Dollars not paid within ninety (90) days from the date of signing of the contract for said building, then we will allow to the Brown Shoe Company six per cent interest from such date until fully paid, with full privilege however, to pay the same or any part thereof at any time before maturity.~~

SEVENTH: It is understood between the parties hereto that Brown Shoe Company, Inc., shall in good faith continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit. It is further understood that the main factory building shall be not less than 40 feet x 250 feet, with an extension 65 ft by 50 ft three stories high. Also, that the amount paid out for labor shall be not less than One Million Two Hundred Fifty Thousand ($1,250,000.00) Dollars during the period of the first ten years, provided an adequate supply of labor is obtainable.

EXHIBIT "11-B"
SHEET 4

4.

It is understood that said Brown Shoe Company, Inc., will carry insurance sufficient in amount to cover the cost of said building or buildings, and in the event of the total or partial destruction of the factory buildings by fire or other casualties the insurance money received by Brown Shoe Company, Inc., shall be employed in the reconstruction or repair thereof without unnecessary delay.

EIGHTH: Brown Shoe Company, Inc., shall, if it accepts this proposition, operate said plant continuously so long as it is practicable in the conduct of its business for at least a period of ten years, but in the event Brown Shoe Company, Inc., shall within said period of ten (10) years elect to discontinue the manufacture of shoes at Sullivan for any cause, Brown Shoe Company, Inc., shall in that event reconvey to the undersigned Sullivan Community Club or to such persons as may be designated to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interest may appear, the factory site and building free of all incumbrances.

5.

We, the undersigned, citizens of the City of Sullivan, Illinois, do hereby guarantee the performance of the above and foregoing contract in behalf of ourselves and others who have signed pledges to secure said funds.

John L Garner
Chester Stone
J. D. Thompson
Paul M Hankla
R. L. Foster
D. L. Butler
Jno. A. Little
L. E. Larrimore
Hayes & Williamson
Capitol Chevrolet Sales
Dee Cleaver
Webb Freeman
S. Federman
R. F. Gordon

D. L. Laughlin
Geo. A. Gentel
W. R. Pepinsky
E. A. McGuire
J. B. Baker
F. L. Lawson
Rufus Applegate
L. S. Thompson
E. Dennis Cook
L. K. Hagerman
G. W. Stevenson
W. K. Holzmueller
H. B. Fulton
Ed. Williamson

Pittsfield, Illinois
November 20, 1933

Brown Shoe Company, Inc.
St. Louis,
Missouri

Gentlemen:

The undersigned Pittsfield Development Association of Pittsfield, Pike County, Illinois a Corporation, by its proper officers and the undersigned citizens hereby make the following proposition for the purpose of inducing you to locate one of your factories for the manufacture of shoes in the said City of Pittsfield, namely:

1st. Within ten days after the signing of this agreement we will furnish and deed or cause to be deeded to you, by a good warranty deed, free of all liens and incumbrances the following property, the West one-half (½) of Block two (2) in original town of Pittsfield bounded as follows; beginning at the South East corner of North Madison and Perry Streets running East 160 feet along Perry Street thence South 340 feet, thence West 160 feet, thence North Along Madison Street 340 feet to the point of beginning, together with the factory building and equipment now located thereon, except the residence and out-buildings which are to be immediately removed. The property deeded to be used for Shoe Factory purposes only.

2d. We will provide, if desired, the right to use the alley for a siding to connect the Shoe Factory through the alley north to the Wabash Railroad.

3d. We will supply the site so selected with the necessary water mains to bring into the premises the city water for use in the factory for factory purposes and for the needs of the employees employed therein.

We will also connect said premises with the city sewers for all practicable purposes.

[illegible] it also granted, if desired, the right to use the alley for a siding to connect the Shoe Factory through the alley north to the Wabash Railroad.

3d. We will supply the site so selected with the necessary water mains to bring into the premises the city water for use in the factory for factory purposes and for the needs of the employees employed therein.

We will also connect said premises with the city sewers for all practicable purposes.

We will connect said premises with electric power wires.

We will have the streets both on the North and West of the Shoe Factory put into good condition as all weather roads.

4th. We will agree to pay you or place at your disposal the sum of Thirty-five Thousand Dollars ($35,000) to be used in the construction of a suitable factory building or buildings and the equipment thereof including a good and sufficient fire extinguisher system, wiring, heating, pumping and the necessary machinery, etc. for the manufacturing of shoes; said factory building or buildings to be erected on the site above described.

5th. Upon the acceptance of this proposition and when the deed to the property has been delivered to Brown Shoe Company, Inc., and the Thirty-five Thousand Dollars ($35,000) has been secured so that the sum shall be available for paying for the factory buildings and the equipment thereon as the work progresses thereon, Brown Shoe Company, Inc. shall proceed without delay to construct and complete the necessary factory buildings and to equip the same as herein contemplated and shall have the same completed at the earliest practical time; it being understood that Ten Thousand Dollars ($10,000) of the said Thirty-five Thousand Dollars ($35,000) shall be paid to the Brown Shoe Company, Inc. on December 1, 1933, Ten Thousand Dollars ($10,000) on January 1, 1934, Five Thousand Dollars ($5,000) on February 1, 1934, Five Thousand Dollars ($5,000) on March 1, 1934, and Five Thousand Dollars ($5,000) on April 1, 1934.

6th. It is understood and agreed between the parties hereto that Brown Shoe Company, Inc. shall in good faith continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit. Also, that the amount paid out for labor shall be not less that Seven Hundred and Fifty Thousand Dollars ($750,000) during the period of the first ten years, provided an adequate supply of labor is secured.

It is understood and agreed that Brown Shoe Company, Inc. will carry insurance sufficient in amount to cover the cost of said building or buildings and equipment, and in the event of the total or partial destruction of the factory buildings by fire or other casualties the insurance money received by Brown Shoe Company, Inc. shall be employed in the

reconstruction or repair thereof without unnecessary delay.

7th. Brown Shoe Company, Inc. shall, if it accepts this proposition, operate said plant continuously so long as it is practical in the conduct of the business for, at least, a period of ten years; but in the event Brown Shoe Company, Inc. shall, within said period of ten(10) years, elect to discontinue the manufacture of shoes at Pittsfield for any cause, shall in that event convey to the undersigned Pittsfield Development Association, its successors or assigns, the factory site above described and buildings and equipment free of all incumbrances.

But it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc. has not control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only as long as necessary.

8th. We pledge to you the loyal and hearty support of our Community represented by the Pittsfield Development Association and the Citizens of Pittsfield in making the factory a success.

Respectfully yours,
PITTSFIELD DEVELOPMENT ASSOCIATION.

G M Smith President Pittsfield Development Association

J. M. Thompson Secretary

Ed R. Quigley
G M Smith
Harry English
Wm. E. Daley
Louis
A E Kay

E E Kay
J M Ryan
J. M. Thompson
Thos Keane
Harry Keane

EXHIBIT "13-M"

cc Mr. H. E. Stevens, Pittsfield

November 21, 1938

Mr. R. L. Harp
Pittsfield
Illinois

Dear Mr. Harp:

Our Engineering Department has been working on plans for the addition at Pittsfield and Saturday and again today Mr. Branch of Pittsfield has been in conferring with Mr. Wolfe. We now have worked out on paper an addition eighty feet North and South by seventy-four feet. This compares with the sixty-three by sixty-three feet which we talked about tentatively when we were in Pittsfield Thursday. The addition will enable us to employ over fifty people in addition to the present force.

Mr. Branch estimates the cost of the bare building at about $10,000, which, with sprinkler system, heating and wiring added, will run the total cost up probably in excess of $17,000. My thought would be, therefore,

shall within said period of ten (10) years elect to discontinue the manufacture of shoes at Sullivan for any cause, Brown Shoe Company, Inc., shall in that event reconvey to the undersigned Sullivan Community Club or to such persons as may be designated to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interest may appear, the factory site and building free of all incumbrances.

But, it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc., has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only as long as necessary.

NINTH: We pledge you the hearty and loyal support of our ~~Business Association~~ Community Club and the citizens in making the factory a success.

IN WITNESS WHEREOF, the Sullivan Community Club has caused these presents to be executed by its President and attested by its Secretary.

ATTEST: _____
Secretary.

SULLIVAN COMMUNITY CLUB
BY E. C. Brandenburg
President.

Rec'd 9 2 9

H. L. Butler

Guy D. Little

L. G. Carmine

Hayes Williamson

Capitol Chevrolet Sales

Des Chapman

Webb Freeman

J. Anderson

P. K. Fowler

M. Patterson

F. E. Dawson

Ruben McDaniel

G. E. Thompson

E. Abernathy

L. K. Hagerman

G. W. Peterson

W. K. Holzmiller

B. E. Fulton

Ed. V. Hamilton

Hagerman

The Brown Shoe Company, Inc., hereby accepts the foregoing proposition and agrees to be bound by its terms thereof.

BROWN SHOE COMPANY, Inc.

BY _____
Vice-President.

ATTEST:

_____
Secretary.

Brown Shoe Company, Inc. hereby accepts the foregoing proposition and agrees to be bound by the terms, therof.

BROWN SHOE COMPANY, INC.

Vice President

ATTEST:

Secretary

EXHIBIT "12-L"
SHEET 2

with Mr. Bolte. We now have marked out on paper an addition eighty feet North and South by seventy-four feet. This compares with the sixty-three by sixty-three feet which we talked about tentatively when we were in Pittsfield Thursday. The addition will enable us to employ over fifty people in addition to the present force.

Mr. Branch estimates the cost of the bare building at about $10,000, which, with sprinkler system, heating and wiring added, will run the total cost up probably in excess of $17,000. My thought would be, therefore, that we enter into an agreement by which the citizens would agree to pay one-half of the total cost up to $12,000, that is, you to pay $6,000 and we to pay the balance if the total cost exceeds $12,000.

If this meets your ideas, I suggest that you draft a simple letter making this proposition to us, have it signed by a group of you, send it in in duplicate, and I will sign one copy in acceptance and return it to you.

We are going right ahead in order to take advantage of this weather, if possible. Mr. Branch hopes to break ground tomorrow morning.

Please remember me very cordially to Messrs. Clandon, English, Thompson and Kientzle, all of whom it was a pleasure to meet again together with you last week.

$6,000 paid in full March

Very truly yours,

EXHIBIT "14-T"
SHEET 1

Caruthersville, Mo., June 15, 1934

Brown Shoe Company, Inc.,
Saint Louis, Missouri

Gentlemen:

The undersigned citizens of the City of Caruthersville, Pemiscot County, State of Missouri, in behalf of themselves and other citizens of said City whom they represent, make you the following proposition to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business in said City of Caruthersville, namely:

1st. Within ten days after signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed free and clear of all liens and incumbrances the agreed upon site and building erected thereon.

2nd. We will immediately proceed with the erection of an addition, on north side of present building, sixty (60) feet by two hundred-fifty (250), material and building to be the same kind as our present building, including heating and plumbing.

Ample sewerage is already connected to building.

3rd. The building is now connected with four inch water mains, but if necessary, we will change to six inch mains, for your water supply & sprinkling system.

The building is already equipped with electric power wires.

We will construct and complete a good gravel street to the front of factory building.

4th. The building is situated just outside the City limits, hence there is no City tax, and this building will not be taken into the [illegible] of this contract.

EXHIBIT "14-W"
SHEET 2

7th Brown Shoe Company, Inc., shall, if it accepts this proposition operate said plant continuously so long as it is practicable in the conduct of its business for at least a period of ten years; but in the event Brown Shoe Company, Inc., shall within said period of ten years elect to discontinue the manufacture of shoes at Caruthersville for any cause, Brown Shoe Company, Inc., shall in that event reconvey to the undersigned Citizens Committee, or their successors, to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interests may appear, the factory site and buildings and equipments free of all incumbrances.

But it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc., has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant: but such shut-down shall continue only so long as necessary.

8th We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

SHOE FACTORY COMMITTEE

H. V. Litzelfelner

A. J. Dillman

W. B. Bernard

N. W. Helm

W. S. Vehi, Chairman

Charleston, Missouri.
May , 193?.

Brown Shoe Company, Inc.
Saint Louis,
Missouri.

Gentlemen:

The undersigned citizens of the City of Charleston, Mississippi County, State of Missouri, in behalf of themselves and other citizens of said city whom they represent, make you the following proposition to induce you to locate one of your factories for the manufacture of shoes and other things needful in the conduct of the business in said city of Charleston, namely:

1st. Within ten days after signing this agreement, we will furnish and deed to you absolutely by a good warranty deed free and clear of all liens and incumbrances the site selected.

2nd. We will have vacated the necessary streets and alleys.

3rd. We will supply the site with the necessary water mains to bring into the premises the city water for use in the factory for factory purposes and for the needs of the employees employed therein, water to be furnished you free for ten years.

We will also connect said premises with the city sewers.

We will connect said premises with electric power wires.

We will have paved or repaired the streets bounding the above factory site.

We will install or have installed by the railroad, the needed railroad siding to connect this site with the Missouri Pacific Railroad, all to be without any cost to you.

4th. We agree to raise and place at your disposal the sum of $60,000.00 in cash to be used for the payment of suitable factory building or buildings and the equipment thereof including power and lighting plants, a good and sufficient fire extinguisher system, wiring, heating, plumbing, and the necessary machinery, etc. for the manufacture of shoes; said factory building or buildings to be erected upon the site selected.

But it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc. has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only as long as necessary.

9th. We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

Charleston Commercial Club,
By Bim W. Stricker
President.

CHARLESTON JUNIOR CHAMBER OF COMMERCE.
By Carl Russell Lamar, President.

CHARLESTON KIWANIS CLUB,
By R. B. Patterson, President.

E. E. Oliver
Mayor of City of Charleston, Mo.

Herf Gurley Pres
A. H. Haydon
Rev. J. R. Fielding
Sydney Marshall
Frank Lay
Charleston Baking Co
E. Morley
J. W. Williams
C. L. Jones

H. G. Simpson
J. F. Bryant
Frank B. Graham
Max Friedman
L. D. Jackson
O. W. Caldwell
H. S. Foster
Organization
H. G. Brashear
Chas. H. Stanfill
H. A. Bruckmyer

[fol. 81] Exhibit "16-P"

R. A. Crawshaw, President R. D. Price, Vice-President
L. C. Pickler, Secretary F. D. Bohannon, Treasurer

Chamber of Commerce
Murphysboro, Ill.

Industry—Commerce—Agriculture
March 22nd, 1939.

Brown Shoe Company,
St. Louis, Missouri.

Gentlemen:

It has come to our attention that your company is contemplating the extension of its activities and the manufacture of some additional lines of shoes.

In view of the long and friendly relations your company has had with the people of Murphysboro, and the manner in which you have always kept faith with our people, we would respectfully suggest that you bring to this city the additional factory facilities needed. As a substantial inducement for you to do this, we would make you the following offer.

If you will construst here an addition of two stories to your present one story building, now forming the southeast wing of the present factory, providing additional floor space approximately 12,000 square feet, we hereby agree to undertake to raise a sum of $10,000.00 and turn this over to your company as evidence of the good will this community has toward you.

Payment of this amount will be made on the basis of $1,000.00 in cash when work on the structure is begun and the balance to be paid as rapidly as can be collected. This offer on our part is made on the understanding;

1. That the proposed addition will cost not less than $20,000.00.

2. That the average payroll of $400,000.00 yearly for the last five years, will be increased by 25 per cent yearly dur-

ing the next ten years, with a corresponding increase in the number of employees by 150.

These we understand were the figures you discussed orally with the committee. If this conforms with your understanding of our oral agreement reached at the meeting Monday in Murphysboro, will you kindly have it approved by the duly authorized officers of your company and return one copy of it to us, keeping the other for your files.

BROWN SHOE COMPANY
E. R. McCarthy, V-Pres.

MURPHYSBORO CHAMBER OF COMMERCE
R. A. Crawshaw, Pres.
L. C. Pickler, Sec'y.

[fol. 82]

Exhibit 17-Q

Brown Shoe Co., Inc.

Schedule of Cash Contributions

Showing Date of Receipt and Contract

Under Which Each Amount Was Received

	Date of Receipt	Amount Received	Total
Dixon, Illinois			
(No contract)			
	12-21-14	$10,000.00	$ 10,000.00
Charleston, Illinois			
Contract dated 4-14-19			
	5- 1-19	$ 10,000.00	
	5-24-19	10,000.00	
	6-13-19	10,000.00	
	6-20-19	10,000.00	
	8- 8-19	10,000.00	
	9-27-19	10,000.00	
	10- 4-19	10,000.00	
	11-14-19	10,000.00	
	12-26-19	8,000.00	
	2- 7-20	2,000.00	
	4-12-20	3,550.00	
	4-13-20	4,450.00	$ 98,000.00

Charleston, Illinois
Contract dated 10-28-24

12- 2-24	$ 10,000.00	
2- 3-25	10,000.00	
4-16-25	5,000.00	25,000.00

Mattoon, Illinois
Contract dated 12-14-21

10- 6-23	$ 1,836.66	
5- 7-24	1,800.00	
5-12-24	33.33	
4-10-25	1,836.66	
3-19-26	1,833.34	
2-24-27	1,833.33	
2-24-27	1,833.33	
2- 3-28	1,833.33	11,006.65

Mattoon, Illinois
Contract dated 3-7-28

3-26-28	$ 10,000.00	
5- 9-28	10,000.00	
6-13-28	30,000.00	
7-11-28	20,000.00	
8- 4-28	10,000.00	
9- 5-28	10,000.00	
10-15-28	10,000.00	
10-31-28	8,552.80	108,552.80

[fol. 83] Union City, Tennessee
Contract dated 11-29-22

12-14-22	$10,000.00	
1-17-23	10,000.00	
2-12-23	20,000.00	
3-13-23	5,000.00	
3-21-23	5,000.00	
4-20-23	5,000.00	
5-14-23	5,000.00	
7-12-23	5,000.00	
9- 8-23	5,000.00	
10-31-23	5,000.00	
11-24-23	5,000.00	
1-24-24	2,000.00	
5- 9-24	1,700.00	
6-27-24	14,300.00	$ 98,000.00

Salem, Illinois
Contract dated 1-3-25

1-21-25	$10,000.00	
3- 9-25	10,000.00	
3-24-25	10,000.00	
4- 8-25	10,000.00	
4-24-25	10,000.00	
5- 5-25	10,000.00	
5-22-25	10,000.00	
6- 5-25	10,000.00	
6-12-25	20,000.00	100,000.00

Salem, Illinois
Contract dated 10-24-27

11-28-27	$10,000.00	
5- 9-28	5,000.00	
11-16-28	5,000.00	
5- 6-29	5,000.00	25,000.00

Litchfield, Illinois
Contract dated 5-23-25

7- 2-25	$ 8,500.00	
10- 1-25	8,500.00	
1-29-26	8,000.00	25,000.00

Vincennes, Indiana
Contract dated 12-15-25

1- 8-26	$10,000.00	
2- 6-26	10,000.00	
2-13-26	10,000.00	
2-24-26	10,000.00	
3-12-26	10,000.00	
3-22-26	10,000.00	
4-15-26	10,000.00	
5-26-26	30,000.00	100,000.00

[fol. 84] Moberly, Missouri
Contract dated 6-1-27

7-27-27	$10,000.00	
8-22-27	10,000.00	
9-12-27	10,000.00	
10- 3-27	10,000.00	
10-17-27	10,000.00	
11-17-27	10,000.00	
11-22-27	14,000.00	$ 74,000.00

City of Carthagerville, namely:

1st. Within ten days after signing of this agreement, we will furnish and deed to you absolutely by a good warranty deed free and clear of all liens and incumbrances the agreed upon site and building erected thereon.

2nd. We will immediately proceed with the erection of an addition, on north side of present building, sixty (60) feet by two hundred-fifty (250), material and building to be the same kind as our present building, including heating and plumbing.

Ample sewerage is already connected to building.

3rd. The building is now connected with four inch water mains, but if necessary, we will change to six inch mains, for your water supply & sprinkling system.

The building is already equipped with electric power wires.

We will construct and complete a good gravel street to the front of factory building.

4th. The building is situated just outside the City limits, hence there is no City tax, and this building will not be taken into the City during the next ten years, the life of this contract.

We agree to pay all State and County taxes, real estate and personal for a period of ten years.

We agree to furnish free of cost your City water for a period of ten years.

5th Upon the acceptance of this proposition, and as soon as work has been started on the addition to the present building, Brown Shoe Company, Inc., shall proceed at once with the contracting for complete sprinkler equipment, under-ground and sprinkler tank and for complete machine equipment for use in this plant.

6th It is understood between the parties hereto that Brown Shoe Company, Inc., shall in good faith continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit, and that the amount paid out for labor shall not be less than seven hundred fifty thousand ($750,000.) dollars during the period of the first ten years, provided an adequate supply of labor is obtainable.

It is understood that said Brown Shoe Company, Inc., will carry insurance sufficient in amount to cover the cost of said building or buildings, and in the event of the total or partial destruction of the factory buildings by fire or other casualties the insurance money received from Brown Shoe Company, Inc., shall be employed in the re-construction or repair thereof without unnecessary delay.

factory site and buildings and equipments free of all incumbrances.

But it is distinctly understood that a shut-down rendered necessary either by fire, war or other casualties, or by causes over which Brown Shoe Company, Inc., has no control, such as panics, epidemics and labor or trade conditions, shall not be considered as a discontinuance of the plant; but such shut-down shall continue only so long as necessary.

5th We pledge you the hearty and loyal support of our Business Association and the citizens in making the factory a success.

SHOE FACTORY COMMITTEE

H. V. Litzelfelner

A. F. Dittman

W. B. Bernard

N. W. Helm

W. S. Wahl, Chairman

IN DUPLICATE

Brown Shoe Company, Inc., hereby accepts the foregoing proposition and agrees to be bound by the terms thereof.

BROWN SHOE COMPANY, INC.,

Vice-President

ATTEST

Secretary

We will install or have installed by the railroad, the needed railroad siding to connect this site with the Missouri Pacific Railroad, all to be without any cost to you.

4th. We agree to raise and place at your disposal the sum of $60,000.00 in cash to be used for the payment of suitable factory building or buildings and the equipment thereof including power and lighting plants, a good and sufficient fire extinguisher system, wiring, heating, plumbing, and the necessary machinery, etc. for the manufacture of shoes; said factory building or buildings to be erected upon the site selected.

5th. Upon the acceptance of this proposition and when the deed to the property has been delivered to Brown Shoe Company, Inc., and the $60,000.00 have been secured so that the sum shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon, Brown Shoe Company, Inc. shall proceed without delay to construct and complete the necessary factory buildings and to equip the same as herein contemplated, and it shall have the same completed at the earliest practicable time; it being understood that $10,000.00 shall be paid to Brown Shoe Company upon the awarding of the building contract and further payments of $10,000.00 as needed to pay for the building and appurtenances as the work progresses, it being understood that the final payment of $10,000.00 shall be made not later than the date the factory is officially opened.

6th. It is understood between the parties hereto the Brown Shoe Company, Inc. shall in good faith continuously operate in the ordinary course of business such factory to as large a capacity as conditions will permit. Also, that the amount paid out for labor shall be not less than Six Hundred Thousand dollars ($600,000.00) during the period of the first ten years, provided an adequate supply of labor is obtainable.

It is understood that said Brown Shoe Company, Inc. will carry insurance sufficient in amount to cover the cost of said building, and in the event of the total or partial destruction of the factory building by fire or other casualties the insurance money received by Brown Shoe Company, Inc. shall be employed in the reconstruction or repair thereof without unnecessary delay.

7th. Brown Shoe Company, Inc. shall, if it accepts this proposition, operate said plant continuously so long as it is practicable in the conduct of its business for at least a period of ten years; but in the event Brown Shoe Company, Inc. shall within said period of ten years elect to discontinue the manufacture of shoes at Charleston for any cause, Brown Shoe Company, Inc. shall in that event reconvey to the undersigned Citizens Committee, or their successors, to be held by them in trust for the citizens contributing to the fund for the establishment of said plant, as their interests may appear, the factory site and building free of all incumbrances.

EXHIBIT 15-O
SHEET 1

Thorsten Baker & Polk

E. Morley

J. W. Williams

C. L. Jones Jr.

L. Forsythe

E. Sylvester

R. B. Haggerty

Brewer & Tribby by B. B. Brewer

L. Class. Kalwing M. D.

W. R. Wells

H. S. Foster

Or assignee

H. G. Brasher

Chas. H. Stanfill

H. A. Bryson

Frost Cross

Cornwall

Geo A. Cox

R. L. Faulkner

W. R. Elson

Richard Dalton

Brown Shoe Company, Inc. hereby accepts the foregoing proposition and agrees to be bound by the terms thereof.

June 14 1937

BROWN SHOE COMPANY, INC.

Vice President

ATTEST:

Secretary

EXHIBIT 15-O
SHEET 2
107

Sullivan, Illinois			
Contract dated October 1929			
	11-14-29	$10,000.00	
	12- 3-29	10,000.00	
	1- 2-30	10,000.00	
	2- 3-30	10,000.00	
	3- 3-30	10,000.00	
	4- 2-30	10,000.00	
	5- 2-30	10,000.00	
	6- 3-30	10,000.00	
	7- 2-30	10,000.00	
	8- 2-30	5,000.00	
	9- 3 30	2,500.00	
	10- 7-30	1,000.00	
	11- 1-30	1,500.00	100,000.00
Pittsfield, Illinois			
Contract dated 11-20-33			
	12- 7-33	$10,000.00	
	1- 2-34	10,000.00	
	2- 2-34	5,000.00	
	3- 2-34	5,000.00	
	4- 3-34	5,000.00	35,000.00
Pittsfield, Illinois			
Agreement dated 11-21-38			
	3-28-39	$ 6,000.00	6,000.00
Charleston, Missouri			
Contract dated 6-14-37			
	7- 1-37	$10,000.00	
	9-30-37	10,000.00	
	9-30-37	10,000.00	
	10-31-37	20,000.00	
	11-27-37	10,000.00	60,000.00
Murphysboro, Illinois			
Contract dated 3-22-39	4-30-39	$ 1,000.00	
	5-31-39	3,000.00	
	6-30-39	4,000.00	
	7-31-39	2,000.00	10,000.00
Total amount contributed in cash			$885,559.45

[fol. 85]

Exhibit "18-R"

Brown Shoe Company, Inc.

Journal Entries Reflecting Receipt of Cash Contributed By Citizens of Sullivan, Illinois—$100,000.00

Cash Account		$100,000.00	
Factory Bonus Fund Account			$100,000.00
11-14-29	$10,000.00		
12- 3-29	10,000.00		
1- 2-30	10,000.00		
2- 3-30	10,000.00		
3- 3-30	10,000.00		
4- 2-30	10,000.00		
5- 2-30	10,000.00		
6- 3-30	10,000.00		
7- 2-30	10,000.00		
8- 2-30	5,000.00		
9- 3-30	2,500.00		
10- 7-30	1,000.00		
11- 1-30	1,500.00		

To record contributions of cash. This cash as received was deposited in the Company's general checking account.

Factory Bonus Fund Account		$100,000.00	
Surplus Account			$100,000.00
4-30-30	$60,000.00		
10-31-30	38,500.00		
4-30-31	1,500.00		
New Construction Account, Sullivan, Illinois		$150,151.95	
Accounts Payable			$150,151.95

Contractor's invoices

[fol. 86]

Accounts Payable		$150,151.95	
Cash Account			$150,151.95

Payment of contractor's invoices in accounting period ended 4-30-30. Checks were drawn on Company's general checking account.

Building Account	$150,151.95	
New Construction Account, Sullivan, Illinois		$150,151.95

To close out New Construction Account.

[fol. 87] Brown Shoe Company, Inc.

Journal Entries Reflecting Receipt of Building Contributed by Citizens of Caruthersville, Mo.

Building Account	$ 71,895.00	
Reserve for Depreciation Account		$ 6,675.37
Factory Bonus Fund Account		65,219.63

Entry of 10-31-34 to record contribution of building.

Factory Bonus Fund Account	$ 65,219.63	
Surplus Account		$ 65,219.63

Entry of 10-31-34 to close out Factory Bonus Fund Accounts.

In re: Brown Shoe Co., Inc.

Schedule of Amounts Contributed by Various Communities, Et

FISCAL YEAR ENDED OCT. 31	LOCATION CONTRIBUTIONS OF CASH	AMOUNT OF CONTRIBUTIONS	Cost of Properties Pursuant to Agreement LAND	BUILDING	MACHINERY	TOTAL	PERCENTAGE
	Dixon, Illinois	$ 10,000.00 (A)					
	Litchfield, Ill.	25,000.00 (A)					
	Charleston, Ill.	123,000.00 (A)					
1923	Union City, Tenn.	$ 98,000.00	$	$164,864.64	$59,409.39	$224,074.03	.437388
1925	Salem, Ill.	125,000.00		159,949.21	104,304.90	264,154.11	.473209
1927	Vincennes, Ind.	100,000.00		130,501.15	129,821.40	260,322.55	.384139
1928	Moberly, Mo.	74,000.00	4,000.00	194,269.68	194,130.95	392,400.63	.188583
1929	Matteson, Ill.	119,559.45		137,398.36	80,125.80	217,524.16	.549637
1931	Sullivan, Ill.	100,000.00		121,514.88	158,510.47	280,025.35	.357111
1934	Pittsfield, Ill.	41,000.00		57,476.64	67,975.00	125,451.64	.326819
1938	Charleston, Mo.	60,000.00		99,069.23	87,690.32	186,699.55	.32 3719
1939	Murphysboro, Ill.	10,000.00		32,164.43		32,164.43	.311182
		$727,559.45	$4,000.00	$1,096,848.22	$881,968.23	$1,982,816.45	
	CONTRIBUTIONS OF BUILDINGS						
1934	Pittsfield, Ill.	$ 20,251.93		$ 20,251.93	$ -0-	$ 20,251.93	
1935	Caruthersville, Mo.	65,219.63		117,426.50	-0-	117,426.50	
1943	Potosi, Mo.	57,953.70	$ 600.00	51,159.02	-0-		
	" " Heating			2,438.85			
	" " Plumbing			2,141.70			
	" " Lighting			1,414.13		57,953.70	
		$143,425.26	$ 600.00	$ 194,832.13		$196,632.13	
		$870,984.71	$4,600.00	$1,291,680.35	$881,968.23	$2178,448.58	
FULLY DEPRECIATED PRIOR TO OCT. 31 - 41 (A)		$158,000.00					
	TOTAL	$1,028,984.71					

NOTE:- Depreciation on donated properties has been disallowed as deductions from gross income for income tax purposes and also the amounts making up the donations have been excluded from invested capital in accordance with C.D. 1582 C.B. 1943, page 1019, Detroit Edison Co. v Com.

ted by Various Communities, Etc.

reement TOTAL	PERCENTAGE	Portion of Contribution Used to Acquire Land	Portion of Contribution Used to Acquire Buildings	Portion of Contribution Used to Acquire Machinery	TOTAL
$224,074.03	.437355		$72,017.00	$25,983.00	$98,000.00
264,164.11	.473209		75,542.00	49,358.00	125,000.00
280,322.58	.384139		50,130.58	49,869.42	100,000.00
392,400.63	.188583	$ 754.33	36,835.95	36,609.72	74,000.00
217,824.16	.549637		75,519.32	44,040.13	119,559.45
280,025.35	.357111		43,394.30	56,605.70	100,000.00
125,451.64	.326819		18,784.46	22,215.54	41,000.00
186,699.55	.32 3719		31,818.78	28,181.22	60,000.00
32,164.45	.311182		10,000.00		10,000.00
$1,982,816.45		$ 754.33	$415,942.39	$312,862.73	$727,559.45
$ 20,251.93			$20,251.93	$ -0-	$20,251.93
117,426.50			65,219.63	-0-	65,219.63
		$ 800.00	51,159.02	-0-	
			2,438.85		
			2,141.70		
57,953.70			1,414.13		57,953.70
$196,632.13			$142,625.26		$143,425.26
$2176,448.58		$ 1,554.33	$558,567.65	$312,862.73	$870,984.71

...e for income tax
...pital in accordance

In re: Brown Shoe Co., Inc. -47-

Depreciation on Portion of Net Amount of Contribution Used to Purchase Property.

LOCATION BUILDING	NET AMOUNT OF CONTRIBUTION	RATE	DEPRECIATION Oct. 31, 1942	Oct. 31, 1943
Union City, Tenn.	$ 72,017.00	3%	$2,160.51	$2,160.51
Salem, Ill.	75,642.00	3%	2,269.26	2,269.26
Vincennes, Ind.	50,130.88	3%	1,503.92	1,503.92
Moberly, Mo.	36,635.95	3%	1,099.08	1,099.08
Mattoon, Ill.	75,519.82	3%	2,265.58	2,265.58
Sullivan, Ill.	43,394.30	3%	1,301.83	1,301.83
Pittsfield, Ill.	39,036.39	3%	1,171.09	1,171.09
Caruthersville, Mo.	65,219.63	3%	1,956.59	1,956.59
Charleston, Mo.	31,818.78	3%	954.56	954.56
Murphysboro, Ill.	10,000.00	3%	300.00	300.00
Potosi, Mo. Bldg.	51,159.02	3%	-0-	1,534.77
" " Heating	2,438.85	5%	-0-	121.94
" " Plumbing	2,141.70	5%	-0-	107.09
Lighting	1,414.13	5%	-0-	70.70
Total			14,982.42	16,816.92
Machinery.				
Sullivan, Ill.	56,605.70	7%	3,962.40	3,962.40
Pittsfield, Ill.	22,215.54	7%	1,555.09	1,555.09
Charleston, Mo.	28,181.22	7%	1,972.69	1,972.69
Total			7,490.18	7,490.18

Recapitulation

	Oct. 31, 1942	Oct. 31, 1943
Portion of Depreciation claimed by Company on Buildings acquired with Contributed Funds	$14,982.42	16,816.92
Portion of Depreciation claimed by Company on Machinery acquired with Contributed funds	7,490.18	7,490.18
TOTAL	$22,472.60	$24,307.10

COST OF PROPERTIES ACQUIRED PURSUANT TO AGREEMENT

BROWN SHOE COMPANY, INC.

DETAIL OF DISTRIBUTION OF CASH CONTRIBUTIONS
PURSUANT TO PETITIONER'S ALTERNATIVE CONTENTION

FISCAL YEAR ENDED OCT 31	LOCATION	AMOUNT OF CONTRIBUTION	NUMBER OF EMPLOYEES TRAINED	COST OF TRAINING EMPLOYEES	NET AMOUNT OF CONTRIBUTION USED TO PURCHASE PROPERTY	LAND	BUILDINGS	MACHINERY	INVENTORY	TOT
	CONTRIBUTIONS OF CASH									
	Dixon, Illinois	$ 10,000.00*								
	Litchfield, Illinois	25,000.00*								
	Charleston, Illinois	125,000.00*								
1925	Union City, Tennessee	98,000.00	275	$ 27,500.00	$ 70,500.00	$	$164,644.64	$ 50,409.36	$ 99,024.69	$31
1926	Salem, Illinois	135,000.00	375	37,500.00	97,500.00		150,649.21	104,304.90	65,689.73	32
1927	Vincennes, Indiana	100,000.00	295	29,500.00	70,500.00		130,501.15	129,821.40	69,799.97	33
1928	Moberly, Missouri	74,000.00	215	21,500.00	52,500.00	4,000.00	104,269.68	104,130.96	309,236.38	60
1929	Mattoon, Illinois	119,559.45	315	31,500.00	88,059.45		137,398.14	80,125.80	44,651.01	26
1931	Sullivan, Illinois	100,000.00	295	29,500.00	70,500.00		121,514.88	158,510.47	80,659.59	30
1934	Pittsfield, Illinois	41,000.00	390	39,000.00	2,000.00		57,476.64	67,975.00	23,111.92	14
1938	Charleston, Missouri	80,000.00	210	21,000.00	59,000.00		99,009.83	97,690.38	9,583.81	19
1939	Murphysboro, Illinois	10,000.00	60	6,000.00	4,000.00		38,184.43	-0-	-0-	3
		$787,559.45	2,430	$343,000.00	$444,559.45	$4,000.00	$1,096,648.22	$881,968.25	$541,697.09	$2,52
	*Fully depreciated prior to Oct 31,1941	156,000.00								
	TOTAL	$943,559.45								

PROPERTIES ACQUIRED PURSUANT TO AGREEMENTS

DISTRIBUTION OF NET AMOUNT OF CONTRIBUTIONS

EXHIBIT "20-T"
SHEET 1

MACHINERY	INVENTORY	TOTAL	PERCENTAGE OF NET AMOUNT OF CONTRIBUTION TO TOTAL COST OF PROPERTIES ACQUIRED	PORTION OF CONTRIBUTION USED TO ACQUIRE LAND	PORTION OF CONTRIBUTION USED TO ACQUIRE BUILDINGS	PORTION OF CONTRIBUTION USED TO ACQUIRE MACHINERY	PORTION OF CONTRIBUTION USED TO ACQUIRE OPENING INVENTORY	TOTAL
$ 59,409.39	$ 99,024.69	$323,098.72	.2181998	$	$ 35,929.74	$ 12,963.09	$ 21,607.17	$ 70,500.00
104,304.90	65,689.73	329,843.84	.2658770		42,404.33	27,669.69	17,425.98	87,500.00
129,881.40	69,799.97	330,122.52	.2135870		27,869.43	27,724.27	14,906.30	70,500.00
194,130.96	209,236.35	601,636.96	.0872819	349.04	16,952.34	16,940.26	18,258.36	52,500.00
80,125.80	44,651.01	268,175.17	.335880		48,149.36	26,912.65	14,997.44	88,059.45
158,510.47	80,659.59	300,684.94	.2344650		28,490.98	37,165.15	4,843.87	70,500.00
87,975.00	23,111.98	148,583.56	.0154622		773.75	915.08	311.17	2,000.00
87,690.38	9,523.81	196,223.36	.1987830		19,678.38	17,428.91	1,892.71	39,000.00
-0-	-0-	32,164.45	-0-		4,000.00	-0-	-0-	4,000.00
$881,968.25	$541,697.09	$2,534,513.52		$349.04	$232,846.31	$167,719.10	$ 94,243.00	$484,559.45

BROWN SHOE COMPANY, INC.

EXHIBIT "BO-T"
SHEET 2

DEPRECIATION ON PORTION OF NET AMOUNT OF CASH CONTRIBUTION USED TO PURCHASE BUILDINGS AND MACHINERY

[illegible]

LOCATION	FISCAL YEAR 1942 BUILDING	MACHINERY	TOTAL	FISCAL YEAR 1943 BUILDING	MACHINERY	TOTAL
Union City, Tennessee	$1,077.89	$ -	$1,077.89	$1,077.89	$ -	$1,077.89
Salem, Illinois	1,272.13	-	1,272.13	1,272.13	-	1,272.13
Vincennes, Indiana	836.08	-	836.08	836.08	-	836.08
Moberly, Missouri	508.57	-	508.57	508.57	-	508.57
Mattoon, Illinois	1,384.48	-	1,384.48	1,384.48	-	1,384.48
Sullivan, Illinois	854.73	2,601.56	3,456.29	854.73	2,601.56	3,456.29
Pittsfield, Illinois	630.77	64.06	694.83	630.77	64.06	694.83
Caruthersville, Missouri	1,956.59	-0-	1,956.59	1,956.59	-0-	1,956.59
Charleston, Missouri	590.35	1,220.02	1,810.37	590.35	1,220.02	1,810.37
Murphysboro, Illinois	120.00	-0-	120.00	120.00	-0-	120.00
Potosi, Missouri	-0-	-0-	-0-	1,534.77	-0-	1,534.77
Do (Heating)	-0-	-0-	-0-	121.94	-0-	121.94
Do (Plumbing)	-0-	-0-	-0-	107.09	-0-	107.09
Do (Lighting)	-0-	-0-	-0-	70.70	-0-	70.70
	$9,231.59	$3,885.64	$13,117.23	$11,066.09	$3,885.64	$14,951.73

123

Exhibit 21-U

December 13, 1943 JAN 1944

Commissioner of Internal Revenue
Washington, D. C.

In re: Brown Shoe Company, Inc., St. Louis, Mo.
Fiscal year ended October 31, 1943--
Election to have unconstitutional tax
recovered during fiscal year 1943 taxed
in fiscal year 1933.

RECEIVED
JAN 1944
AUDIT REVIEW DIVISION D

Dear Sir:

During the fiscal year ended October 31, 1943, Brown Shoe Company, Inc. recovered the sum of $4,250.00 plus interest thereon representing a portion of the floor stock taxes paid by this Company on floor stocks at August 1, 1933. Such tax was paid during the fiscal year ended October 31, 1933 and was claimed as a deduction on the Company's return for that year.

Under the provisions of Section 128 of the Internal Revenue Code, the Company hereby elects to treat the said amount of $4,250.00 as not having been allowable for the fiscal year ended October 31, 1933, and consequently not includible in its taxable income for the fiscal year ended October 31, 1943.

The said amount of $4,250.00 plus interest was received by Brown Shoe Company on May 26, 1943.

Brown Shoe Company hereby consents to the inclusion of the said amount of $4,250.00 in its taxable income as otherwise computed for the fiscal year ended October 31, 1933 and consents to the assessment for the fiscal year ended October 31, 1933 of any deficiency together with interest thereon as provided by law, resulting from the addition to taxable income as otherwise computed for the said fiscal year of the amount of $4,250.00.

its taxable income for the fiscal year ended October 31, 1943.

The said amount of $4,250.00 plus interest was received by Brown Shoe Company on May 26, 1943.

Brown Shoe Company hereby consents to the inclusion of the said amount of $4,250.00 in its taxable income as otherwise computed for the fiscal year ended October 31, 1933 and consents to the assessment for the fiscal year ended October 31, 1933 of any deficiency together with interest thereon as provided by law, resulting from the addition to taxable income as otherwise computed for the said fiscal year of the amount of $4,250.00.

Computation of amended 1933 tax on income is presented in the schedule below.

Yours very truly,

BROWN SHOE COMPANY, INC.

COMPUTATION OF AMENDED 1933 TAX ON INCOME

Corrected net income as shown by stipulation agreement	$1,626,369.73
Add recovery of cotton floor stock taxes	4,250.00
Amended net income	$1,630,619.73
Tax on amended net income (@ 13-3/4%)	$ 224,210.21
Tax on corrected net income as shown by stipulation agreement	223,925.84
Additional tax	$ 284.37

49-C

[fol. 93] Official Report of Proceedings
Before
The Tax Court of the United States

(Filed October 16, 1947, The Tax Court of the United States)

Brown Shoe Co., Inc., Petitioner,
Docket No. 11394 vs.
Commissioner of Internal Revenue, Respondent.

[fol. 94] U. S. District Court Room No. 2,
Federal Building,
11th and Market Streets,
St. Louis, Mo.,
September 24, 1947—2:00 P. M.

(Met pursuant to notice.)

Before: Honorable J. Edgar Murdock, Judge
Appearances:

Chas. B. McInnis, Esq., Atty., Transportation Bldg., Washington, D. C., for the Petitioner.

George E. Gibson, Esq., 2155 Railway Exchange Bldg., Bureau of Internal Revenue, St. Louis, Mo., for the Respondent.

[fol. 95] Proceedings

The Clerk: Docket No. 11394, Brown Shoe Co., Inc.

Mr. McInnis: Charles B. McInnis, Transportation Building, Washington, D. C., for the Petitioner.

Mr. Gibson: George E. Gibson, Bureau of Internal Revenue, 2155 Railway Exchange Building, St. Louis, Mo., for the Respondent.

The Court: You may proceed.

Mr. McInnis: If your Honor please, before I make my opening statement I would like to file a motion to amend the petition in some slight respects so as to permit me to raise one alternative issue. Copy of the proposed amendment has been handed to counsel for Respondent, and I understand he has no objection.

Mr. Gibson: There is no objection to the motion, your Honor.

The Court: It may be filed.

Mr. Gibson: It requires no further pleadings on the part of the Respondent.

The Court: All right.

Opening Statement on Behalf of the Petitioner
By Mr. McInnis

Mr. McInnis: If your Honor please, this case involves the fiscal years ended October 31, 1942, and October 31, [fol. 96] 1943.

One of the original issues, accelerated depreciation, has been fully stipulated and is no longer in the case. That leaves three other principal issues. Two of those issues involve cash and property received from community groups.

For a number of years prior to the taxable years here involved, this petitioner had received from certain community groups cash and in two instances property as an inducement to locate and operate shoe factories within the particular communities. With one exception, such donations or gifts were made pursuant to written contracts, copies of which are in the stipulation.

In computing Petitioner's depreciation for fiscal years 1942 and 1943, Respondent eliminated what he considered to be the depreciation upon the assets acquired with the donated cash, and of course the depreciation in the entire amount of the two properties received as property. Petitioner challenges that, and contends in the first instance that this case is distinguishable from Detroit Edison in that here the community groups were in the business of making gifts, and they said they were making gifts to this taxpayer as we will try to develop from the contracts them- [fol. 97] selves. We attempt to distinguish Detroit Edison upon that ground, that the Supreme Court there said the donors were users in the rural communities and had no intention of making a gift, and cash or property were not gifts. Here we are endeavoring to show they were gifts.

We have the alternative issue under that point. We say if the depreciation on the portion of the property acquired

with donated cash is to be eliminated, then we question the Respondent's method of determining that depreciation. In the instances where the taxpayer received cash, the Respondent allocated that cash to buildings and machinery by taking the ratio of the total of the two to the total cost of the plant. In every instance, the amount donated was less than the cost of the plant. In that way, the Commissioner arrived at the amount of machinery he considered to have been acquired with donated cash, and the amount for buildings, and, working on that basis, eliminated the depreciation of the buildings and machinery.

We challenge that by contending if you are going to eliminate any depreciation it should be in smaller amounts. We contend that the purpose of the donation was to induce [fol. 98] the Petitioner to construct and operate a factory in the particular community, using local labor, which you will see from the contract was a consideration motivating the contributing groups.

We contend if you are going to allocate the cash at all, it should be allocated not only to buildings, to machinery and to land in one or two instances where land was purchased, but also the cost of training the new employees, which was the cost met by the Petitioner at the outset before it could start operating the plant. We contend the purpose of that donation was as much to reimburse the Petitioner for the cost of training new employees as it was for any other purpose. We have facts in the stipulation showing cost of training employees and the allegation on that basis if your Honor should concur that the taxpayer is right.

The next principal issue relates to invested capital, and turns on the same facts. The Respondent as eliminated from Petitioner's invested capital the amount of nine hundred and seventy-one odd thousand dollars, which is the total aggregate amount of the contributions plus the value of these two plants. His explanation in eliminating it from invested capital was that it was not contributed capital. [fol. 99] The Petitioner did not claim it in the first instance, and did not claim it in its primary issue as contributed capital. We claim it is accumulated earnings and profits.

The taxpayer brought it in, in the first instance, as part of the earnings surplus. We contend it constitutes part of

Moberly, Missouri	508.57	*	508.57	508.57	*	508.57
Mattoon, Illinois	1,384.48	*	1,384.48	1,384.48	*	1,384.48
Sullivan, Illinois	854.73	2,601.56	3,456.29	854.73	2,601.56	3,456.29
Pittsfield, Illinois	630.77	64.06	694.83	630.77	64.06	694.83
Caruthersville, Missouri	1,956.59	-0-	1,956.59	1,956.59	-0-	1,956.59
Charleston, Missouri	590.35	1,220.02	1,810.37	590.35	1,280.02	1,810.37
Murphysboro, Illinois	120.00	-0-	120.00	120.00	-0-	120.00
Potosi, Missouri	-0-	-0-	-0-	1,534.77	-0-	1,534.77
Do (Heating)	-0-	-0-	-0-	121.94	-0-	121.94
Do (Plumbing)	-0-	-0-	-0-	107.09	-0-	107.09
Do (Lighting)	-0-	-0-	-0-	70.70	-0-	70.70
	$9,231.59	$7,885.64	$13,117.23	$11,066.09	$3,885.64	$14,951.73

RECAPITULATION

	AMOUNT	
	Fiscal Year 1942	Fiscal Year 1943
Portion of depreciation claimed by Company on buildings acquired with contributed cash	$9,231.59	$11,066.09
Portion of depreciation claimed by Company on machinery acquired with contributed cash	3,885.64	3,885.64
Total depreciation claimed by Company on assets acquired with contributed cash	$13,117.23	$14,951.73

* Fully depreciated prior to October 31, 1941

Petitioner's accumulated earnings and profits. If it were to be distributed to Petitioner's stockholders it would be taxable in the hands of the stockholders under Section 115. Consequently, by definition and the Commissioner's regulations, it is made part of Petitioner's accumulated earnings and profits.

We contend in the alternative, if your Honor concludes it is not part of surplus earnings and profits, it is contributed capital. And we rely upon the three separate and distinct ideas as specified by Section 217(a) (12) as the purpose for which money and property may be paid in and included in invested capital. Your Honor will recall it is money paid in as capital, or money paid in as paid in surplus, or money or property paid as a contribution to capital. We recognize, in the alternative, all contributions to capital as meaning something other than paid in surplus. We think, paid in surplus would include all contributions made to the stock-
[fol. 100] holders themselves and would come in as capital stock or paid in surplus. Congress in using this test term "as a contribution to capital", must have intended the contributions made to someone other than the stockholders.

The third issue relates to the receipt by Petitioner in the fiscal year ended October 31, 1943, of the amount of $4,250.00, representing refund of tax which petitioner had paid and had deducted in its return for the fiscal year ended October 31, 1933. And we rely on Section 128 of the Code, which permits the taxpayer by filing an appropriate waiver and otherwise complying with the Commissioner's regulations to have that income subject to tax at the 1933 rate as part of its 1933 income. In effect, to have that portion of its deductions for 1933 disallowed.

In this case, this Petitioner had appealed to the Board of Tax Appeals for the fiscal year 1933. That case had been settled by stipulation, I believe, with the Board of Tax Appeals of that court. Being closed by the statute of limitations, it was closed by the final order of the Board of Tax Appeals.

In this issue we are squarely in conflict with the Commissioner's regulations, for those regulations specifically provide after a case has been appealed to the Board of
[fol. 101] Tax Appeals or Tax Court and settled by final

stipulation, the taxpayer may not have the benefit of the deductions. We think the regulation is contrary to the statute. Congress did not limit the relief to the taxpayer whose case had been closed by the statute of limitations but wasn't closed by the final stipulation of the Board of Tax Appeals or the court.

The facts are fully stipulated. After counsel for Respondent makes his statement, I would like to offer a stipulation of facts.

Mr. Gibson: I think Mr. McInnis has covered the issues, and I will waive any statement at this time.

Mr. McInnis: It is a joint stipulation, and it makes no difference who offers it.

The Court: The stipulation may be received.

Mr. Gibson: The Respondent has an objection to Paragraph 14 of the stipulation of facts. I wish to renew the objection for the record at this time.

The Court: I will rule on it now. The objection is overruled, and the exception noted. It may be received for what it may be worth. If it is immaterial, I will not have to pay attention to it.

Mr. McInnis: There is one other stipulation for the record we have agreed upon.

[fol. 102] Mr. Gibson: The stipulation is as follows: Petitioner had accumulated earnings and profits in excess of the amount of $971,031.01 at all times material to the issues in this case.

The Court: The record may show the parties are agreed on that as an official stipulation.

The case stands submitted upon this record.

Mr. Gibson: Yes, sir.

The Court: How do you want to file briefs?

Mr. McInnis: I would suggest this is the type of case that will lend itself to consecutive briefs, and that will be agreeable to me if it is to your Honor.

The Court: How long do you want?

Mr. McInnis: I think I can do it in thirty days. I note it is thirty days to October 24, which is all right, and I would suggest the following Monday, the 27th.

The Court: Does that make thirty-three days?

Mr. McInnis: Yes, I believe it does.

The Court: All right.

Mr. Gibson: May the Respondent have thirty days there-after?

The Court: That is all right, and fifteen days to reply. It is thirty-three days, thirty days and fifteen days.

[fol. 103] (Whereupon, at 2:15 o'clock P. M., September 24, 1947, the hearing was closed.)

[fol. 104] Petition of Commissioner of Internal Revenue for Review of Decision of The Tax Court of the United States and Statement of Points).

(Received and Filed July 28, The Tax Court of the United States).

In the United States Circuit Court of Appeals
Eighth Circuit

Commissioner Of Internal Revenue, Petitioner on Review,
No. 11394 vs. T. C. Docket
Brown Shoe Company, Inc., Respondent on Review.

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Now comes the Commissioner of Internal Revenue, by his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and respectfully shows:

I.

Jurisdiction

The petitioner on review is the duly appointed, qualified and acting Commissioner of Internal Revenue (hereinafter referred to as the Commissioner), holding his office by virutue of the laws of the United States.

The respondent on review, Brown Shoe Company, Inc. (hereinafter referred to as the taxpayer), is a corporation organized and existing under the laws of the State of New York having its principal office at 16th and Washington Streets, St. Louis, Missouri. The taxpayer filed its Federal excess-profits tax returns for the fiscal years ended October 31, 1942 and October 31, 1943, the taxable years here involved, with the Collector of Internal Revenue for the First District of Missouri, whose office is located at St. Louis, [fol. 105] Missouri, and within the judicial circuit of the United States Circuit Court of Appeals for the Eighth Circuit, where this review is sought.

The Commissioner files this petition pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II

Prior Proceedings

The Commissioner determined deficiencies in respect of the taxpayer's Federal excess-profits tax liability for the fiscal years ended October 31, 1942 and October 31, 1943 in the respective amounts of $58,235.09 and $85,748.37. The taxpayer appealed to The Tax Court of the United States from the determination so made by the Commissioner and under date of February 13, 1948 the Tax Court promulgated its findings of fact and opinion, 10 T. C. No. 35, in accordance with which opinion the Court entered its decision on April 30, 1948 "that there are deficiencies in excess profits tax of $32,398.09 and $52,347.92 for the fiscal years ended October 31, 1942 and October 31, 1943, respectively."

III

Nature Of Controversy

Two issues were presented to the Tax Court for its consideration and determination, the first one of which issues had to do with the exclusion by the Commissioner from the taxpayer's equity invested capital of the sum of $971,031.01, representing money and buildings received from communities in which the taxpayer operated factories, and the second issue having to do with the disallowance by

the Commissioner of depreciation on buildings thus acquired by the taxpayer and on others built with the funds [fol. 106] thus acquired. The only issue decided contrary to the Commissioner's determination relates to that part of the second issue which involves depreciation on buildings and machinery acquired by the taxpayer with the cash received by it from the community groups, the decision of the Tax Court in respect of which issue forms the basis of the review herein sought.

During the period 1919 up to October 31, 1939 the taxpayer received cash in the amount of $885,559.45 and buildings worth $85,471.56 from various community groups in 12 different towns. The contributions so received by the taxpayer were received under contracts which varied somewhat in their provisions but each agreement generally required the taxpayer to acquire a factory in the town and to operate it for a specified period of time. If the conditions of the contract were fulfilled, the amount involved was to be refunded. In one case involving $10,000 there was no contract. The cash so received by the taxpayer was deposited in its general bank account and "was not earmarked for or held intact and applied against the cost of the factory, machinery, equipment or other items applicable to the plant acquired or constructed in the particular community." In his determination the Commissioner disallowed depreciation claimed by the taxpayer for each year on the buildings contributed by citizens of two communities and likewise disallowed "additional amounts which he determined to be the depreciation deductsd by Petitioner for the respective taxable years on buildings and machinery acquired with the cash received by Petitioner from thee community groups:" The Tax Court sustained the Commissioner's determination in disallowing depreciation on the two buildings contributed by citizens of two communities but refused to sustain his determination in disallowing depreciation on buildings, machinery and equip- [fol. 107] ment acquired by the taxpayer with the cash received by it from community groups. Accordingly the Tax Court reduced the deficiencies determined by the Commissioner to the amounts hereinabove indicated and entered its decision in accordance with its redetermination.

IV

Statement Of Points

Following is a concise statement of the points upon which the Commissioner intends to rely in the review herein, to-wit:

The Tax Court of the United States erred:

1. In entering its decision to the effect that there are deficiencies in excess-profits taxes for the fiscal years ended October 31, 1942 and October 31, 1943 in the respective amounts of only $32,398.09 and $52,347.92.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner except as modified by stipulation of the parties in respect of an issue not here involved.

3. In holding and deciding that the taxpayer is entitled to use as a part of its cost basis for depreciation on buildings built by it and machinery and equipment acquired by it the cash received by the taxpayer from community groups in the amount of, to-wit, $885,559.45.

4. In failing and refusing to hold and decide that the taxpayer is not entitled to use as a part of its cost basis for depreciation on buildings built by it and machinery and equipment acquired by it the cash received by the taxpayer from community groups in the amount of, to-wit, $885,559.45.

[fol. 108] 5. In that its opinion and its decision are not supported by but are contrary to the facts as stipulated by the parties.

6. In that its opinion and its decision are not supported by the evidence and are contrary to law.

Wherefor, the Commissioner petitions that the decision of The Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that

appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

THERON L. CAUDLE
Assistant Attorney General
CHARLES OLIPHANT
Chief Counsel
Bureau of Internal Revenue
Attorneys for Petitioner on Review

[fol. 109] (Notice of Filing of Petition For Review by Commissioner of Internal Revenue and Acknowledgment of Service by Counsel For Respondent).

(Received July 28, 1948, and marked filed on July 28, 1948 and July 30, 1948, The Tax Court of the United States).

To:
Charles B. McInnis, Esquire
Transportation Building
Washington 6, D. C.

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of July, 1948, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of this Court heretofore rendered in the above-entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

Dated this 28th day of July, 1948.

VICTOR S. MERSCH
Clerk, The Tax Court of the United States.

Service of copy of petition for review acknowledged this 29th day of July, 1948.

CHAS. B. McINNIS
Counsel for Respondent on Review.
Per Harold A. Kertz.

[fol. 110] (Notice of Filing of Petition For Review by Commissioner of Internal Revenue and Acknowledgement of Service by Respondent).

(Received and Filed August 3, 1948, The Tax Court of The United States).

To:
Brown Shoe Company, Inc.
1610 Washington Avenue
St. Louis, Missouri

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of July, 1948, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 28th day of July, 1948.

CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 30th day of July, 1948.

BROWN SHOE COMPANY, INC.
By C. P. Evans, Secy.
Respondent on Review.

[fol. 111] (Petition of Brown Shoe Company, Inc., For Review of Decision of The Tax Court of The United States.

(Filed July 30, 1948, The Tax Court of The United States).

In The
United States Circuit Court of Appeals
For The Eighth Circuit.

Brown Shoe Company, Inc., Petitioner on Review
No. 11394 v. T. C. Docket
Commissioner Of Internal Revenue, Respondent on Review

To the Honorable Judges of the United States Circuit Court of Appeals of the Eighth Circuit:

Comes now petitioner, Brown Shoe Company, Inc., by its attorney, Charles B. McInnis, and respectfully shows that:

I.

Jurisdiction.

Petitioner, Brown Shoe Company, Inc., is a corporation duly organized and exisiting under the laws of the State [fol. 112] of New York, with its principal office at 16th and Washington Streets, St. Louis, Missouri. The returns for the fiscal years ended October 31, 1942, and October 31, 1943, the taxable periods here involved, were filed with the Collector of Internal Revenue for the First District of Missouri at St. Louis, Missouri, which is within the jurisdiction of the United States Court of Appeals for the Eighth Circuit.

This petition is filed pursuant to Sections 1141 and 1142 of the Internal Revenue Code, Title 26, U. S. C. A. 1141 and 1142, for a review of the decision of the Tax Court of the United States entered in the above-entitled cause on April 30, 1948.

II.

Prior Proceedings.

The Commissioner of Internal Revenue determined deficiencies in respect of petitioner's excess profits tax liability for the fiscal year ended October 31, 1942, in the amount of $58,235.09, and of excess profits tax for the fiscal year ended October 31, 1943, in the amount of $85,748.37. The petitioner filed with the Tax Court of the United States a petition for a redetermination of the proposed deficiencies. The matter was duly heard on the pleadings and on a stipulation of facts with exhibits attached thereto, on September 24, 1947. The Tax Court [fol. 113] of the United States promulgated its findings

of facts and its opinion on February 13, 1948, (10 T. C. No. 35), and entered its decision on April 30, 1948, ordering and deciding that there are deficiencies in excess profits tax of $32,398.09 and $52,347.92 for the fiscal years ended October 31, 1942 and October 31, 1943, respectively.

III.

Nature Of Controversy.

Two issues were presented to the Tax Court for its decision. The first issue had to do with the exclusion from petitioner's equity invested capital of the sum of $971,031.01, representing money and buildings received by petitioner from community groups in communities in which petitioner operated factories. The petitioner respectfully requests a review of the decision of the Tax Court in respect to that issue.

The second issue had to do with the disallowance by the Commissioner of a deduction for depreciation on (a) buildings thus acquired by the petitioner, and (b) buildings and equipment acquired, as the respondent alleged and the petitioner denied, with money received from community groups. On this issue the Tax Court decided that petitioner was not entitled to a deduction for depreciation on the buildings thus acquired, but was entitled to a deduction for depreciation on the other items. As to the second issue, petitioner respectfully requests a review of the decision of the Tax Court only in so far as it disallowed depreciation on the said buildings.

[fol. 114] The petitioner manufacturers shoes in a number of towns in the States of Missouri, Illinois, Indiana and Tennessee. During the period from 1919 up to October 1939, the petitioner received $885,559.45 in cash and $85,471.56 in buildings from various community groups in twelve different towns, the total amounting to $971,031.01. In all cases, except one involving $10,000 cash, there were contracts with the respective community groups. Those contracts varied, but generally they required the petitioner either to construct a new factory or to enlarge an existing facory in the particular community and to operate it for

an agreed period of time, the petitioner to employ a stipulated number of employees and to meet a specified payroll during a stipulated period of time. The amount involved was to be refunded if petitioner failed to comply with the terms of the contract. If it did comply with all the terms, petitioner was thereafter free to operate the factories in any way it desired or to dispose of the factories and to retain the proceeds without any obligation to account to the contributing group.

Certain of the cash payments received by petitioner from the community groups were credited directly to petitioner's Earned Surplus Account, while the other cash payments, when received, were credited to Contributed Surplus and subsequently transferred to its Earned Surplus Account. The value of the buildings was set up in a Buildings Account, carried as an asset, and credited to petitioner's Surplus Account.

[fol. 115] The cash when received was deposited in petitioner's general bank account and the cost of constructing the buildings and additions, and of the machinery, etc., was paid out of petitioner's general bank account. The cash received by petitioner from a particular community group "was not earmarked for or held intact and applied against the cost of the factory; machinery, equipment or other items applicable to the plant acquired or constructed in the particular community."

In computing its excess profits tax for the two fiscal years mentioned above, the petitioner included in its equity invested capital the aforementioned amount of $971,031.01 representing money and buildings received from community groups.

In determining the deficiencies for those two years, the Commissioner of Internal Revenue (a) reduced petitioner's equity invested capital by $971,031.01 representing the cash and value of the buildings received by petitioner prior to the first fiscal year involved herein; (b) disallowed the deduction for depreciation of the buildings which petitioner had received from the community group; and (c) disallowed "additional amounts which he determined to be the depreciation deducted by petitioner for the

respective taxable years on buildings and machinery acquired with the cash received by petitioner from the community groups."

The Tax Court of the United States sustained the Commissioner's determination (a) in reducing petitioner's equity invested capital by the amount of $971,031.01 and [fol. 116] (b) in disallowing depreciation on the buildings received from community groups but refused to sustain his determination (c) in disallowing depreciation on buildings and machinery which he determined, but petitioner denied, had been acquired with the cash received by petitioner from the community groups.

IV.

Points Relied Upon By Petitioner.

Petitioner is agrieved by the findings of fact and conclusions of law of the Tax Court of the United States, in so far as that tribual decided (a) that the amount of $971,031.01 was not includable in petitioner's equity invested capital, and (b) that the petitioner was not entitled to deduct, in computing its taxable income, depreciation on the buildings which it had received from the community groups and to which it held title.

The petitioner desires to obtain a review of the decision of the Tax Court of the United States by the United States Circuit Court for the Eighth Circuit and relies in the review herein on the following points:

The Tax Court of the United States erred:

1. In entering its decision to the effect that there are deficiencies in excess profits tax for the fiscal years ended October 31, 1942, and October 31, 1943, in the respective amounts of $32,398.09 and $52,347.92.

2. In failing and refusing to expunge the deficiencies in tax determined by the Commissioner.

[fol. 117] 3. In holding and deciding that the amount of $971,031.01, representing cash and property previously received from community groups is not includable in petitioner's equity invested capital as part of petitioner's

"accumulated earnings and profits" within the meaning of Section 718 (a) (4) of the Internal Revenue Code.

4. In holding and deciding that the said amount of $971,031.01 is not includable in petitioner's equity invested capital as money and property paid in as a "contribution to capital" within the meaning of Section 718 (a) (1) and (2) of the Internal Revenue Code.

5. In holding and deciding that the taxpayer was not entitled to a deduction for depreciation on the buildings which had been previously contributed directly to petitioner by certain community groups.

6. In that the opinion and decision of the Tax Court are not supported by, but are contrary to, the facts as stipulated by the parties.

7. In that its opinion and decision are not supported by the evidence and are contrary to law.

Wherefore, the petitioner respectfully requests that the decision of the Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, and that the errors complained of be reviewed and corrected by said Court.

CHARLES B. McINNIS
Attorney for Petitioner
Brown Shoe Company, Inc.

[fol. 118] District of Columbia: ss

Charles B. McInnis, being duly sworn, states that he is attorney of record for petitioner in the above-entitled case, that he has read the foregoing petition, and that the statements contained therein are true to the best of his knowledge, information and belief.

CHARLES B. McINNIS.

Subscribed and sworn to before me, a Notary Public this 30th day of July, 1948.

FLORENCE A. SMITH.
Notary Public.

My commission expires March 14, 1952.

[fol. 119] (Notice of filing of Petition for Review by Brown Shoe Company, Inc., and Acknowledgment of Service.)

(Filed July 30, 1948, The Tax Court of the United States.)

To: Charles Oliphant, Esquire
Bureau of Internal Revenue
Washington, D. C.

You are hereby notified that the petitioner, Brown Shoe Company, Inc., did, on the 30th day of July, 1948, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of this Court heretofore rendered in the above-entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

Dated this 30th day of July, 1948.

CHARLES B. McINNIS,
Attorney for Petitioner
Brown Shoe Company, Inc.

Service of copy of petition for review acknowledged this 30th day of July, 1948.

CHARLES OLIPHANT,
Counsel for Respondent
on Review.

[fol. 120] Joint Praecipé for Record.

(Received and Filed October 15, 1948, The Tax Court of the United States.)

In The United States Circuit Court Of Appeals For The Eighth Circuit.

Commissioner Of Internal Revenue,
Petitioner on Review,
No. 11,394. vs. T. C. Docket.
Brown Shoe Company, Inc.,
Respondent on Review.

Brown Shoe Company, Inc.,
Petitioner on Review,
No. 11,394. vs. T. C. Docket.
Commissioner Of Internal Revenue,
Respondent on Review.

To the Clerk of The Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, copies duly certified as correct of the following documents and records in the above-entitled causes in connection with the petitions for review by the said Circuit Court of Appeals for the Eighth Circuit, heretofore filed by the taxpayer and the Commissioner of Internal Revenue:

1. Docket entries of the proceedings.
2. Pleadings:
   (a) Petition and answer
   (b) Amendment to petition and answer (Answer not of record).
3. Opinion of Tax Court
4. Decision entered April 30, 1948
5. Stipulation of Facts and Exhibits attached thereto.

[fol. 121] 6. Official Report of Proceedings held September 24, 1947, (including stipulation of parties on page 9).

7. Petition for review filed by the Commissioner Internal Revenue including statement of points to be relied upon, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

8. Petition for review filed by the taxpayer including statement of points to be relied upon, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

9. Orders enlarging time for the preparation, transmission and filing of the records on review.

10. This joint praecipe for record.

Said transcript to be prepared, certified and transmitted as required by the law and the rules of the United States Circuit Court of Appeals for the Eighth Circuit.

CHAS. B. McINNIS,
Attorney for Taxpayer.

THERON L. CAUDLE,
Assistant Attorney General.

CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Commissoner of Internal Revenue.

CRM/hhs 8/16/48

[fol. 122] (Clerk's Certificate to Transcript.)

The Tax Court Of The United States
Washington

Commissioner Of Internal Revenue, Petitioner,
Docket No. 11,394. vs.
Brown Shoe Company, Inc.,
Respondent.

Brown Shoe Company, Inc., Petitioner,
Commissioner Of Internal Revenue, Respondent.

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing pages 1 to 121, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

Seal
The Tax Court
of the U. S.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia this 21st day of October, 1948.

EMT

VICTOR S. MERSCH,
Clerk,
The Tax Court of the United States.

No. 13,851 Filed Oct. 27, 1948, E. E. Koch, Clerk.
No. 13,852 Filed Nov. 1, 1948, E. E. Koch, Clerk.

[fol. 123] (Order of The Tax Court of the United States extending time to file Record on Petitions for Review.)

The Tax Court Of The United States
Washington

Commissioner Of Internal Revenue,
Petitioner,
Docket No. 11,394. vs.
Brown Shoe Company, Inc., Respondent.

Brown Shoe Company, Inc., Petitioner,
Docket No. 11,394. vs.
Commissioner Of Internal Revenue,
Respondent.

Upon motion of counsel for the parties, it is

Ordered that the time for preparation, transmission and delivery of the record sur petitions for review of the above entitled proceedings in the United States Circuit Court of Appeals for the Eighth Circuit is extended to October 28, 1948.

JOHN W. KERN,
Acting Presiding Judge.

Dated: Washington, D. C.
August 19, 1948

evd

Now: October 21, 1948, the foregoing order is certified from the record as a true copy.

Seal
The Tax Court
of the U. S.

VICTOR S. MERSCH,
Clerk.

[fol. 145] And thereafter the following proceedings were had in said causes in the United States Court of Appeals for the Eighth Circuit, viz.:

(Appearance of Mr. Theron Lamar Caudle and Mr. Ellis N. Slack as Counsel for Petitioner in Cause No. 13,851.)

United States Court of Appeals

Eighth Circuit.

Commissioner of Internal Revenue, Petitioner,
No. 13,851. vs.
Brown Shoe Company, Inc.

The Clerk will enter my appearance as Counsel for the Petitioner.

THERON LAMAR CAUDLE,
Assistant Attorney General,

ELLIS N. SLACK,
Special Assistant to The Attorney General.

(Endorsed): Filed in U. S. Court of Appeals, Nov. 1, 1948.

(Appearance of Mr. Charles Oliphant and Mr. Charles E. Lowery as Counsel for Petitioner in Cause No. 13,851.)

The Clerk will enter my appearance as Counsel for the Petitioner.

CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue.

[fol. 146]

CHARLES E. LOWERY,
Special Attorney, Bureau of Internal Revenue.

(Endorsed): Filed in U. S. Court of Appeals, Nov. 10, 1948.

(Appearance of Counsel for Respondent in Cause No. 13,851.)

The Clerk will enter my appearance as Counsel for the Respondent.

CHARLES B. McINNIS,
Transportation Building,
Washington 6, D. C.

(Endorsed): Filed in U. S. Court of Appeals, Nov. 1, 1948.

(Appearance of Counsel for Petitioner in Cause No. 13,852.)

United States Court of Appeals

Eighth Circuit.

Brown Shoe Company, Inc., Petitioner,
No. 13,852. vs.
Commissioner of Internal Revenue.

The Clerk will enter my appearance as Counsel for the Petitioner.

CHARLES B. McINNIS,
Transportation Building,
Washington 6, D. C.

(Endorsed): Filed in U. S. Court of Appeals, Nov. 1, 1948.

[fol. 147] (Appearance of Mr. Theron Lamar Caudle and Mr. Ellis N. Slack as Counsel for Respondent in Cause No. 13,852.)

The Clerk will enter my appearance as Counsel for the Respondent.

THERON LAMAR CAUDLE,
Assistant Attorney General,

ELLIS N. SLACK,
Special Assistant to The Attorney General.

(Endorsed): Filed in U. S. Court of Appeals, Nov. 1, 1948.

(Appearance of Mr. Charles Oliphant and Mr. Charles E. Lowery as Counsel for Respondent in Cause No. 13,852.)

The Clerk will enter my appearance as Counsel for the Respondent.

CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue,

CHARLES E. LOWERY,
Special Attorney, Bureau of Internal Revenue.

(Endorsed): Filed in U. S. Court of Appeals, Nov. 10, 1948.

[fol. 148] (Appearance of Mr. Lee A. Jackson and Mr. Carlton Fox as Counsel for Commissioner of Internal Revenue in Causes Nos. 13,851 and 13,852.)

United States Court of Appeals
for the
Eighth Circuit.

Nos. 13,851 and 13,852.

Commissioner of Internal Revenue, Petitioner,
vs.
Brown Shoe Company, Inc.,
and
Brown Shoe Company, Inc., Petitioner,
vs.
Commissioner of Internal Revenue.

The Clerk will enter our appearance as Counsel for the Commissioner.

THERON LAMAR CAUDLE,
Assistant Attorney General,

ELLIS N. SLACK,

LEE A. JACKSON,

CARLTON FOX,
Special Assistants to The Attorney General.

(Endorsed): Filed in U. S. Court of Appeals, Mar. 7, 1949.

[fol. 149] (Order of Submission in Causes Nos. 13,851 and 13,852.)

March Term, 1949.

Thursday, March 10, 1949.

These causes, Nos. 13,851 and 13,852, having been called for hearing in their regular order, are argued together, and argument was commenced by Mr. Charles B. McInnis for Brown Shoe Company, Inc., continued by Mr. Carlton Fox, Special Assistant to The Attorney General; for Commissioner of Internal Revenue, and concluded by Mr. Charles B. McInnis for Brown Shoe Company, Inc.

Thereupon, these causes were submitted to the Court on the printed record and the briefs of counsel filed herein.

[fol. 150] (Opinion in Causes Nos. 13,851 and 13,852.)

United States Court of Appeals
For The Eighth Circuit.

No. 13,851.

Commissioner of Internal Revenue, Petitioner, vs. Brown Shoe Company, Inc., Respondent.	Petition to Review Decision of The Tax Court of the United States.

No. 13,852.

Brown Shoe Company, Inc.,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.

Petition to Review Decision of The Tax Court of the United States.

[June 17, 1949.]

Mr. Charles B. McInnis (Mr. Ernest M. Callomon and Messrs. Roberts & McInnis were with him on the brief), for Brown Shoe Company, Inc.

Mr. Carlton Fox, Special Assistant to the Attorney General (Mr. Theron Lamar Caudle, Assistant Attorney General, and Mr. Ellis N. Slack and Mr. Lee A. Jackson, Special Assistants to the Attorney General, were with him on the brief), for Commissioner of Internal Revenue.

Before GARDNER, Chief Judge, and WOODROUGH and THOMAS, Circuit Judges.

THOMAS, Circuit Judge, delivered the opinion of the Court.

Two petitions have been filed in this court to review a decision of the Tax Court of the United States entered April 30, 1948 (10 T.C. 291), involving excess profits taxes

of the Brown Shoe Company, Inc., for the fiscal years ended October 31, 1942, and 1943. The case was taken to the Tax Court on an appeal by the Shoe Company from the determination of deficiencies by the Commissioner. The issues were submitted to the Tax Court upon a Stipulation of Facts; and the parties have agreed that the petitions may be submitted here on a single record. It will be convenient, therefore, to consider both petitions in one opinion.

The Brown Shoe Company, Inc., is a New York corporation with its principal office at St. Louis, Missouri. It is engaged in manufacturing and selling shoes at several different plants in the states of Missouri, Illinois, Indiana, and Tennessee.

During the period from 1914 to October, 1939, the taxpayer received $885,559.45 in cash and two factory buildings of the aggregate agreed value of $85,471.56 from various community groups in 12 different towns, amounting in all to $971,031.01. In each of these cases, except one involving a donation of $10,000 cash, there was a contract between the taxpayer and the community group. Copies of all such contracts are attached to the Stipulation of Facts. Such contracts varied in some particulars, but generally they required the taxpayer to construct a new factory or to enlarge an existing one in the particular community, to operate it for an agreed period of time, usually 10 years, to employ a stipulated number of employees, and to meet a minimum stipulated pay roll during the period agreed upon.

Usually the contract provided that the cash donated was "to be used for the payment of suitable factory building or buildings and the equipment thereof" and that payment was to be made to the taxpayer "so that the same shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon."

The contracts further provided that in the event the taxpayer failed to comply with their terms the amount of the cash donation in each case should be refunded, and in the case of the two buildings title was to be transferred back to the donors. In case of compliance with the terms of the contracts, the taxpayer was thereafter free to operate the factories as it desired, or to dispose of the factories and retain the proceeds without obligation to account to the donors.

The cash received by the taxpayer from particular groups was not earmarked for or held intact and applied against the cost of the factory and equipment acquired or constructed in the particular community but was deposited by the taxpayer in its general bank account and debited to cash on the debit side of its ledger and credited to its earned surplus account or, in some cases, to contributed surplus and thereafter transferred to earned surplus.

In its appeal to the Tax Court the taxpayer complained of three acts of the Commissioner in determining deficiencies in its excess profits net income for the taxable years involved.

First, the Commissioner excluded from the taxpayer's claimed equity invested capital the sum of $971,031.01, representing cash and the value of buildings donated by the several community groups where it built new or enlarged existing factories.

Second, the Commissioner disallowed a deduction on account of depreciation claimed by the taxpayer on the two donated buildings valued at $85,471.56; and

Third, the Commissioner disallowed a claimed deduction for depreciation on factories and equipment to the extent of $885,559.45, which the Commissioner found represented property acquired with donated funds.

The Tax Court affirmed the first and second determinations of the Commissioner, and its decision in these respects is the basis of the complaint in the taxpayer's petition for review. The Tax Court reversed the Commissioner's third determination, supra, and its decision in this respect is the basis of the Commissioner's complaint.

We shall first consider the Commissioner's case. He contends that there is no evidence to support the Tax Court's finding and conclusion that ". . . no justification appears for the action of the Commissioner in disallowing depreciation on buildings, machinery and equipment upon the theory that the petitioner used cash received from the various communities to pay for those buildings and that machinery, and, consequently, the buildings and machinery had, to that extent, no cost to the petitioner. The parties have stipulated that the cash was not earmarked in any way and it is just as reasonable to assume that it was used for any one of a dozen other purposes as it is to make the Commissioner's assumption. The petitioner paid for the buildings and machinery out of its own unrestricted funds, those buildings and that machinery had cost to it, as shown on its books and records, and it is entitled to depreciation thereon."

The "Commissioner's assumption" and the facts referred to by the Tax Court are stated in paragraphs 9 and 11 of the Stipulation of Facts as follows:

"9 . . . The cash when received was deposited in Petitioner's general bank account and debited to Cash on the asset side of Petitioner's ledger. The cost of constructing the buildings and the additions, machinery, etc., was paid from Petitioner's general bank account, and debited to Cost of Buildings, Cost of Equipment, or Cost of Machinery, depending upon the nature of the particular expenditure, for the plant in question. The cash received by Petitioner from a particular community group was not earmarked for or held intact and applied against the cost of the factory, machinery, equipment, or other items appli-

cable to the plant acquired or constructed in the particular community, . . .

. . . . . .

"11. In every instance the cash received by Petitioner from the community groups . . . was less than the amount expended by Petitioner for the acquisition or construction of the factory building and the machinery of said factory. In determining the amount of depreciation to be disallowed for the fiscal years ended October 31, 1942, and October 31, 1943, attributable to the assets acquired with the contributed cash, Respondent first determined the total cost to Petitioner of the factory building, the land, in instances where land was purchased by Petitioner, and the machinery and he then allocated the cash contribution received by Petitioner from the citizens of the particular community to the cost of buildings, land, in instances where land was acquired, and machinery, in the ratio of the total cost of each of said items to the aggregate cost of all of said items for the particular factory . . ."

In considering the question thus presented by the Commissioner we have jurisdiction to review a decision of the Tax Court in the same manner and to the same extent as we have to review a decision of a district court in civil actions tried without a jury. 26 U.S.C.A. § 1141(a). Upon review there is thus made applicable to the decisions of the Tax Court Rule 52(a) of the Federal Rules of Civil procedure (28 U.S.C.A. following § 723c), wherein it is stated that "Findings of fact shall not be set aside unless clearly erroneous . . ." A finding of the Tax Court, however, is "clearly erroneous" when, "although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States* v. *Gypsum Co.*, 333 U.S. 364, 395.

The question here is, "What is the basis for depreciation of the factory buildings and equipment involved?" The Tax Court correctly held that cost is the correct basis. 26 U.S.C.A. § 114. But "cost" means cost to the taxpayer.

Detroit Edison Co. v. *Commissioner*, 319 U.S. 98, 102. And cost to the taxpayer does not include contributions from others made for business or community interests. *Commissioner* v. *Arundel-Brooks Construction Corp.*, 4 Cir., 152 F.2d 225, 162 A.L.R. 1200; *C. L. Downey Co.* v. *Commissioner*, 8 Cir., 172 F.2d 810.

We think the Tax Court committed a clear mistake of law and fact when it concluded that the application of the donated funds to the cost of the factories and machinery depended upon the taxpayer's accounting system, and that upon that basis "it is just as reasonable to assume that it was used for any one of a dozen other purposes as it is to make the Commissioner's assumption." In the absence of proof to the contrary the only reasonable assumption is that the taxpayer faithfully performed its obligations under the contracts entered into with the community groups that contributed the funds in question. It could do that just as well by depositing those funds in and paying them out of its general bank account as it could by earmarking them in some manner and depositing them in a special account.

Further, the Tax Court's "assumption" in this regard is inconsistent with its further assumption stated in its opinion where it is declared that "It seems proper to assume that the petitioner [taxpayer] fulfilled all conditions attached to the transaction, since neither party suggests contrary." One of the conditions of these contracts was that the cash contributed was "to be used for the payment of suitable factory building or buildings and the equipment thereof . . .", and the taxpayer agreed to construct the building or buildings in accordance with the terms of the contract, obligating "itself to use [the sum donated] for the payment of the constructing of a suitable factory building or buildings and the equipment thereof . . ."

Of course, when the taxpayer deposited such donations in its general account in a bank it augmented its credit

balance proportionately, and when it drew checks against that balance to pay for the construction of a factory building the balance was reduced accordingly. Since the buildings and the equipment were all paid for in accordance with the contracts, neither the absence of earmarks on the deposit nor the entry of the transaction in the taxpayer's books supports an assumption that such funds were not applied in good faith to the purposes for which they were received. The decision of the Tax Court assailed by the Commissioner's petition to review must accordingly be and it is reversed.

We now turn to a consideration of the issues presented by the taxpayer's pefition.

Excess profit tax laws came into the internal revenue system of the United States as war measures. The first of such taxes was imposed by the 1917, 1918 and 1921 Act. It provided for levying "War Excess Profit Taxes" upon corporations, partnerships, and individuals. The question presented here arises under the 1940 Act, (54 Stat. 975, 26 U.S.C. § 710 et seq.), passed to tax abnormally high profits due to large governmental expenses for national defense. H.R. Rep. No. 2894, 76th Congress, 3d Sess., 1-2. The scheme of these laws, although differing in particular provisions is the same. In so far as material in this case under the 1940 Act controlling here, the amount of income subject to an excess profits tax is computed by subtracting from the net income subject to regular income tax an amount equal to 8 per centum of the taxpayer's (equity) invested capital for the taxable year. Pursuant to this scheme it is the taxpayer's right, and to its interest, to include in its invested capital account all assets legally includible therein and thus augment the 8 per centum deduction to which it is entitled under the law; while it is the duty of the Commissioner to exclude therefrom every item to which the taxpayer is not lawfully entitled.

The regular excess profits tax is imposed only upon the income remaining after deducting the 8 per centum of the taxpayer's invested capital. This 8 per centum of income was regarded by Congress as the taxpayer's normal and fair return upon its invested capital.

In the instant case the taxpayer's first contention is that the Commissioner and the Tax Court erred in respect of the amount of its equity invested capital. It argues that the amount of $971,031.01, representing cash and property received from community groups, is includible in its equity invested capital either as a "contribution to capital" within the meaning of § 718(a)(1) and (2) of the Internal Revenue Code or as part of its "accumulated earnings and profits" within the meaning of § 718(a)(4) of the Internal Revenue Code.

The statute (26 U.S.C., 1946 ed.) reads:

"§ 718. **Equity invested capital.**

"(a) **Definition.** The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

"(1) **Money paid in.** Money previously paid in for stock or as paid-in surplus, or as a contribution to capital;

"(2) **Property paid in.** Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital . . .

* * * * * * *

"(4) **Earnings and profits at beginning of year.** The accumulated earnings and profits as of the beginning of such taxable year."

The taxpayer argues that in excluding from its capital structure the $971,031.01, and also in excluding the value of the two buildings received from the community groups, the Commissioner acted upon an erroneous conception of the meaning of "normal earnings" or a normal and fair return on the taxpayer's invested capital, in that he im-

puted to the meaning of those terms the same meaning which applied to them under the 1917 Act whereas they had an entirely different meaning under that Act from that in the Act of 1940. This difference, it is argued, is due to the difference between what may be included in "invested capital" under the two Acts.

The Supreme Court in *LaBelle Iron Works* v. *United States*, 256 U.S. 377, 388, a case arising under the 1917 Act, said: "The word 'invested' in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the act deals with, 'to invest' imports a laying out of money, or of money's worth, either by an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business; . . ."

Under this definition of "invested capital" it is obvious the Commissioner did not err in excluding the money and buildings contributed to the taxpayer here from its invested capital account.

The argument is that that rule is not applicable under the 1940 Act. Our attention has not been called to any case, and we have found none, in which the Supreme Court has definitely stated what may be included by the taxpayer under all circumstances in its capital account under the 1940 Act. However, in the case of *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, the Court had under consideration the right of a taxpayer to include in its invested capital as "accumulated earnings and profits as of the beginning of such taxable year" the uncollected balances on installment sales made during the taxable year. In its discussion of the meaning of these words of the statute the Court said (P. 497): "It thus appears that by this method

Congress intended, with minor exceptions not here relevant, to impose the excess profits tax on all annual net income in excess of 8% of a corporation's working capital, including its accumulated profits." The Court concluded: "The respondent [taxpayer] can include in its equity invested capital only that portion of its profits from installment payments which it has actually received and on which it has already paid income taxes in the years of receipt."

This case, we think, whatever may be the proper conception of normal earnings under the 1940 Act, settles adversely to the taxpayer the contention that the amount of $971,031.01 representing the money and property received from community groups may be included in its invested capital under § 718(a)(4) as "accumulated earnings and profits as of the beginning of such taxable year" for the reason that it did not include any part of that amount in its income tax returns and pay income taxes thereon "in the years of receipt." Cf. *Frederick Smith Enterprise Co.* v. *Commissioner*, 6 Cir., 167 F.2d 356, 361.

It remains to determine whether the amount of $971,031.01 received as stated, supra, is includible in invested capital as "money previously paid in . . . as a contribution to capital" within the meaning of § 718(a)(1) and (2). The Tax Court, citing its own decision in *The McKay Products Corporation* v. *Commissioner*, 9 T.C. 1082, and other of its own decisions held it was not includible because "the transferors were not stockholders" of the taxpayer. This is consistent with the decision of the Supreme Court in the *LaBelle Iron Works* case, *supra*, decided under the 1917 Act.

At this point the taxpayer argues that the conception of capital and earnings of a corporation under the 1940 Act

differs from the conception thereof in the 1917 Act. To support this point it cites § 35.718-1 of Regulation 112 relating to the excess profits tax under the Internal Revenue Code, as amended for the taxable years beginning after December 31, 1941, reading in part:

"If the property was acquired after December 31, 1920, by a corporation from a shareholder as paid-in surplus, *or from any person as a contribution to capital*, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made." (Emphasis supplied).

The taxpayer further calls attention to the statement in the Commissioner's brief wherein he says:

"Although the contributions here in question were undoubtedly contributions to the taxpayer's capital in the general sense of that term, so as to distinguish them from its income, they do not constitute 'a contribution to capital' within the meaning of that term as it is used in Section 718(a)(1) and (2) of the Internal Revenue Code . . ."

The regulation called to our attention is not helpful because it does not limit or define the meaning of the capital of a corporation as these words are used in the 1940 Act, and the quotation from the Commissioner's brief serves only to direct attention to the Commissioner's theory that the capital of a corporation, as that term is used in the statute, consists only of the capital as defined in its charter and paid in by the stockholders, and that there can be no "contributions to capital" unless a deficit exists therein, because unless such a deficit exists any contribution to the corporation is necessarily made to "paid-in surplus" within the meaning of § 718(a)(1) and (2), supra. Support for this theory of corporate accounting within the meaning of the revenue laws is found in *Detroit Edison Co.* v. *Com-*

missioner, 319 U.S. 98; *Willcuts* v. *Milton Dairy Co.*, 275 U.S. 215; *Edwards* v. *Douglas*, 269 U.S. 204; *Van Norman Co.* v. *Welch*, 1 Cir., 141 F.2d 99; *Foley Securities Corp.* v. *Commissioner*, 8 Cir., 106 F.2d 731; *Musical Instrument Sales Co.* v. *Anderson*, 2 Cir., 40 F.2d 454; and *McKay Products Corp.* v. *Commissioner*, 9 T.C. 1082. Until the Supreme Court has construed the 1940 Act otherwise we cannot say that the decision of the Tax Court in this regard is clearly erroneous.

Finally, the taxpayer contends that in computing its taxable income for the two fiscal years in question it is entitled to deduct depreciation on the two buildings received directly from the community groups to induce the taxpayer to locate a factory in the community, and that the Tax Court erred in holding otherwise. This identical point was presented to this court recently in the case of *C. L. Downey Co.* v. *Commissioner*, 8 Cir., 172 F.2d 810. We there held that a manufacturing company was not entitled in computing its income and excess profits tax to a deduction for depreciation on a factory building paid for with funds contributed by a community group to induce the taxpayer to locate its factory in their community, on the ground that under the statute, 26 U.S.C.A. § 114, depreciation is allowable only on the cost to the taxpayer of the property. We are unable to distinguish the facts in this case from the facts in that case. That decision is, therefore, binding here, requiring an affirmance of the Tax Court on this issue.

The result is that the decision of the Tax Court is reversed on the Commissioner's petition for review and affirmed on the taxpayer's petition, and the case is remanded to the Tax Court.

[fol. 163] (Judgment in Causes Nos. 13,851 and 13,852.)

United States Court of Appeals

for the

Eighth Circuit.

May Term, 1949.

Friday, June 17, 1949.

Commissioner of Internal Revenue, Petitioner,
No. 13,851. vs.
Brown Shoe Company, Inc.

Petition to Review Decision of The Tax Court of the United States.

and

Brown Shoe Company, Inc., Petitioner,
No. 13,852. vs.
Commissioner of Internal Revenue.

Petition to Review Decision of The Tax Court of the United States.

These causes came on to be heard on the petitions to review a decision of The Tax Court of the United States entered April 30, 1948, involving excess profits taxes of the Brown Shoe Company, Inc., for the fiscal years ended October 31, 1942, and 1943, and were argued by counsel.

On Consideration Whereof, It is now here ordered and adjudged by this Court that the decision of the said Tax Court assailed by the petition to review filed by the Commissioner of Internal Revenue be, and is hereby, reversed, and upon the issues raised by the taxpayer Brown Shoe Company, Inc., the decision of the said Tax Court is hereby affirmed.

And it is further ordered by this Court that these mat-
[fol. 164] ters be, and they are hereby, remanded to the said Tax Court for proceedings consistent with the opinion of this Court this day filed herein.

June 17, 1949.

(Order enlarging time to and including August 2, 1949, in which to file petition of Brown Shoe Company, Inc. for rehearing, in Causes Nos. 13,851 and 13,852.)

May Term, 1949.

Friday, July 1, 1949.

On motion of counsel for the Brown Shoe Company, Inc., in the above cases, and for cause shown, and it appearing that counsel for the Commissioner of Internal Revenue has no objection to the motion, it is Ordered by the Court that the time for filing a petition for rehearing by the Brown Shoe Company herein be, and is hereby, enlarged to and including August 2, 1949.

July 1, 1949.

IN THE

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

Nos. 13,851 and 13,852

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BROWN SHOE COMPANY, INC., RESPONDENT

BROWN SHOE COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petitions for Review of the Decision of the Tax Court of the United States

---

TAXPAYER'S PETITION FOR REHEARING

Now comes the taxpayer, Brown Shoe Company, Inc., by its attorney, and respectfully petitions this honorable Court to set aside its opinion and grant a rehearing of this

cause upon the following grounds and for the following reasons:*

1. The Court inadvertently overlooked a material matter of fact in holding that the Tax Court committed a clear mistake of law and fact when it concluded that the application of the donated funds to the cost of the factories and machinery depended upon the taxpayer's accounting system, whereas the Tax Court's finding on this point was based upon a clear stipulation of fact.

2. The Court has inadvertently overlooked, and failed to pass upon, the alternative contention of the taxpayer, as set forth in its reply brief (pages 9 and following), that if this Court should set aside the findings of the Tax Court and determine that the contributions should be allocated to the cost of factories established or enlarged in the particular communities from which the contributions were received, then this Court should determine that such contributions should be allocated to all of the items which the taxpayer was required to provide in the particular factories, namely, the cost of land, buildings, machinery, opening inventories and the cost of training new employees, all of which were necessary for the establishment of a new factory or the enlargement of an existing factory.

3. The Court inadvertently overlooked material matters of law when it states (page 8 of the pamphlet opinion) that

> "The regular income tax is imposed only upon the income remaining after deducting the 8 per centum of the taxpayer's invested capital."

This statement is not correct with respect to the method of computing the taxpayer's regular income tax for the two

* The period within which to file a petition for a rehearing has been extended by the Court until August 2, 1949.

taxable years here involved, namely, the fiscal years ended October 31, 1942 and October 31, 1943. The regular corporation income tax was imposed for each of those two fiscal years on a separate and entirely different basis.

4. The Court inadvertently assumed that the decision of the United States Supreme Court in *Commissioner* v. *South Texas Lumber Co.*, 333 U. S. 496, held that any money or property received by a corporate taxpayer may not be included in its "accumulated earnings and profits" within the meaning of Section 718(a)(4) of the Internal Revenue Code, where no income taxes were paid on such money or property in the year of receipt, whereas the decision of the United States Supreme Court in that case merely upheld the validity of the Commissioner's regulations relating to the determination of accumulated earnings and profits of a taxpayer using the installment basis of reporting taxable income under section 44, I. R. C.

5. The Court inadvertently overlooked the fact that, in holding that property and money received by the taxpayer from community groups do not constitute contributions to capital within the meaning of section 718(a)(1) and (2) of the Internal Revenue Code because such contributions were not made by shareholders, and because "we cannot say that the decision of the Tax Court in this regard is clearly erroneous," it has impliedly invalidated excess profits tax Regulation 112, section 35.718-1 and income tax Regulation 111, section 29.113(a)(8)-1 both of which provide that a contribution to capital may be made "by any person."

Conclusion

For the reasons herein stated it is respectfully requested that this Court grant a rehearing for further consideration of the questions raised in this petition to the end that

judgment of this Court may, if the Court sees fit, be modified so as to provide for reversal of the decision of the Tax Court on the taxpayer's petition for review and for an affirmance of the Tax Court's decision on the Commissioner's petition for review, or, in the alternative, that the case be remanded with instructions to the Tax Court to allocate the cash contributions to all of the items covered by the contracts as contended for by the taxpayer in its alternative argument.

Respectfully submitted,

CHARLES B. MCINNIS,
Mayflower Office Building,
Washington 6, D. C.,
Attorney for the Taxpayer,
Brown Shoe Company, Inc.

ROBERTS & MCINNIS,
ERNEST M. CALLOMON,
Mayflower Office Building,
Washington 6, D. C.,
Of Counsel.

CHARLES B. MCINNIS, Counsel for Taxpayer, hereby certifies that this petition is believed to be well founded in law and fact, and is presented in good faith and is believed to be meritorious.

CHARLES B. MCINNIS,
Attorney for Brown Shoe Company, Inc.

* * * * * * *

(Endorsed:) Filed in U. S. Court of Appeals, Aug. 1, 1949.

[fol. 169] (Order denying Petition of Brown Shoe Company, Inc., for Rehearing in Causes Nos. 13,851 and 13,852.)

May Term, 1949.

Monday, August 8, 1949.

The petition for a rehearing filed by the Brown Shoe Company, Inc., in these causes has been considered by the Court, and it is now here Ordered that same be, and it is hereby, denied.

August 8, 1949.

[fol. 170] (Clerk's Certificate.)

United States Court of Appeals

Eighth Circuit.

I, E. E. Koch, Clerk of the United States Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the record on petitions to review the decision of The Tax Court of the United States, as prepared and printed under the rules of the United States Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, and full, true and complete copies of the pleadings, record entries and proceedings, including the opinion, had and filed in the United States Court of Appeals for the Eighth Circuit, except the full captions, titles and endorsements omitted in pursuance of the rules of the Supreme Court of the United States, in certain causes in said Court of Appeals wherein Commissioner of Internal Revenue was Petitioner and Brown Shoe Company, Inc., was Respondent, No. 13,851, and Brown Shoe Company, Inc., was Petitioner and Commissioner of Internal Revenue was Respondent, No. 13,852, as full, true and complete as the originals of the same remain on file and of record in my office.

I do further certify that on the 22nd day of August, A. D. 1949, a mandate was issued out of said Court of Appeals in said causes, directed to The Tax Court of the United States.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of the United States Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, this 17th day of October, A. D. 1949.

E. E. KOCH,
Clerk of the United States Court of Appeals for the Eighth Circuit.

(Seal)

[fol. 171] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1949

No. 445

ORDER ALLOWING CERTIORARI—Filed January 9, 1950

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Douglas took no part in the consideration or decision of this application.

INDEX

	Page
Opinion below	1
Jurisdiction	2
Questions presented	2
Statute and regulations involved	2
Statement	3
Specification of errors to be urged	7
Reasons for granting the writ	9
Conclusion	22
Appendix	23

CITATIONS

Cases:

Commissioner v. *Bedford*, 325 U. S. 283	17
Commissioner v. *Munter*, 331 U. S. 210	17
Commissioner v. *Phipps*, 336 U. S. 410	17
Commissioner v. *South Texas Lumber Co.*, 333 U. S. 496	10, 15, 16, 17
Commissioner v. *Wheeler*, 324 U. S. 542	14, 17
De Ganay v. *Lederer*, 250 U. S. 376	12
Detroit Edison Co. v. *Commissioner*, 319 U. S. 98	19, 21
Downey Co., C. L., 10 T. C. 837	20
Downey Co., C. L. v. *Commissioner*, 172 F. (2d) 810	4, 9, 10, 21
Edwards v. *Cuba Railroad Co.*, 268 U. S. 628	11, 12
Edwards v. *Douglas*, 269 U. S. 204	17
Foster v. *United States*, 303 U. S. 118	15
Frank Holton & Co., 10 B.T.A. 1317	4, 10
Helvering v. *Canfield*, 291 U. S. 163	16
La Belle Iron Works v. *United States*, 256 U. S. 377	13
Lynch v. *Hornby*, 247 U. S. 339	17, 18
Lynch v. *Turrish*, 247 U. S. 221	16
McKay Products Corporation, 9 T. C. 1082	9, 11, 21
Peabody v. *Eisner*, 247 U. S. 347	16
Randall v. *Bailey*, 23 N. Y. S. (2d) 173, aff'd. 288 N. Y. 280, 43 N. E. (2d) 43	18
Texas & Pacific Railway Co. v. *United States*, 286 U. S. 285	11

Statutes:

	Page
Federal Rules of Civil Procedure:	
Rule 52(a)	7
Internal Revenue Code:	
Sec. 23(l), (n)	23
Sec. 44	17
Sec. 113 (a), (8)	12, 15, 21, 23
Sec. 114	24
Sec. 115 (a), (b)	10, 16, 24
Sec. 712 (a)	25
Sec. 714	26
Sec. 717	4, 13
Sec 718 (a)(1)(2)(4)	2, 4, 8, 10, 11, 13, 16, 18, 26, 27
Sec. 719	4, 13
Sec. 728	10, 18, 28
Revenue Act of 1917 (c. 63, 40 Stat. 300) Sec. 207(a)	13
Revenue Act of 1918 (c. 18, 40 Stat. 1057) Sec. 326(a)	13
Revenue Act of 1921 (c. 136, 42 Stat. 227) Sec. 326(a)	13
Revenue Act of 1932 (c. 209, 47 Stat. 169) Sec. 113(a)(8)	12
Revenue Act of 1934 (c. 277, 48 Stat. 169)	14
Revenue Act of 1942 (c. 619, 56 Stat. 798) Sec. 121(c)	23
Sec. 217	26
Sec. 218	27
Second Revenue Act of 1940 (c. 757, 54 Stat. 974)	13, 14, 25, 26, 27, 28
Stock Corporation Law (c. 59 of the Consolidated Laws of New York) Sec. 58	18
U. S. Code, Title 28, Sec. 1254	2

Miscellaneous:

Treasury Regulations 86, Art. 113(a)(8)-1	14
Treasury Regulations 94, Art. 113(a)(8)-1	15
Treasury Regulations 101, Art. 113(a)(8)-1	15

Page
Treasury Regulations 103, Sec. 19.113(a)(8)-1 15, 28
Sec. 19.115-3 29
Treasury Regulations 109, Sec. 30.718.-1-2 15, 30, 31
Treasury Regulations 111, Sec. 29.113(a)(8)-1 15, 28
Sec. 29.115-3 17, 29
Treasury Regulations 112, Sec. 35.718-1 15, 30
Sec. 35.718-2 18, 31
Uniform System of Accounting for Steam Railways, "Accounting Classification," effective January 1, 1942 9

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No.

BROWN SHOE COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The petitioner, Brown Shoe Company, Inc., hereinafter referred to as the taxpayer, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered on June 17, 1949, in the above entitled cause and in the cause entitled *Commissioner of Internal Revenue* v. *Brown Shoe Company, Inc.*, which were heard on a consolidated record.

Opinion Below

The opinion of the Tax Court (R. 23-26) is reported in 10 T.C. 291. The opinion of the Court of Appeals (R. 148-160) is reported in 175 F. (2d) 305 (advance sheets).

Jurisdiction

The judgment of the Court of Appeals was entered on June 17, 1949 (R. 161). Taxpayer's petition for rehearing was denied by the Court of Appeals on August 8, 1949 (R. 167). The jurisdiction of this Court is invoked under Title 28, U. S. Code, Section 1254.

Questions Presented

1. Is the amount of $971,031.01, representing cash and property received by the taxpayer from various community groups as an inducement to locate a new plant or enlarge an existing plant in the particular community, includable in taxpayer's equity invested capital, either as a "contribution to capital" within the meaning of Section 718(a)(1) and (2) of the Internal Revenue Code, or as part of its "accumulated earnings and profits" within the meaning of Section 718(a) (4) of the Internal Revenue Code?

2. Does the cash in the amount of $885,559.45, received by the taxpayer from the community groups and deposited in its unrestricted bank account, reduce the taxpayer's "basis" for depreciation of buildings and machinery and equipment constructed or acquired by the taxpayer in the respective communities?

3. Is the taxpayer entitled to deduct depreciation on the two factory buildings which it received directly from two of the community groups, the said buildings having stipulated bases of $20,251.93 and $65,219.63, respectively?

Statute and Regulations Involved

The pertinent provisions of the statute and regulations are printed in the Appendix, *infra*, pages 23-32.

Statement

This proceeding involves deficiencies in taxpayer's excess profits tax for the fiscal years ended October 31, 1942 and October 31, 1943. The facts have been fully stipulated (R. 27-123, 129) and may be summarized as follows:

The taxpayer is a corporation organized and existing under the laws of the state of New York with its principal office at St. Louis, Missouri. It is engaged in the business of manufacturing and selling at wholesale men's, women's and children's shoes, conducting its operation in a number of different plants located in the states of Missouri, Illinois, Indiana and Tennessee (R. 24, 27, 28).

During the period from 1914 up to October, 1939, the taxpayer received $885,559.45 in cash and $85,471.56 (stipulated value) in buildings from various community groups as an inducement to locate a new plant, or enlarge an existing plant, in the particular community, the total amounting to $971,031.01 (R. 24, 28, 29). In all cases except one there were contracts between the taxpayer and the respective community groups. These contracts varied, but generally required the taxpayer to construct a new factory, or enlarge an existing factory, in the particular community, operate it for an agreed period of time, meet a specified payroll during the agreed period of time and employ a stipulated number of employees. In ten instances the amount was to be refunded, or the factory building erected was to be transferred, to the particular community group if the taxpayer failed to comply with the terms of the contract (R. 24). In one instance involving the payment to the taxpayer of $10,000 cash, there was no contract with the community group; the minutes of the meeting of the taxpayer's Board of Directors merely state that a "bonus" of $10,000 had been paid "as a part of our organization expenses in starting the factory" in Dixon, Illinois (R. 28). In six

instances the agreements between the taxpayer and the respective community groups contain no obligation for any repayment of the funds, or transfer of the property. The amounts involved in those six instances totaled $102,006.65 (R. 39, 41-47, 69, 71-73, 99, 108-109). In one of them, cash of $10,000 was paid to the taxpayer "as evidence of the good-will this community has toward you" (R. 108, 109).

In all cases the money or property involved was transferred or paid over to the taxpayer outright.[1] The stipulated period, provided for in eleven of the contracts, during which the taxpayer was to operate the plant and meet the other conditions specified, had expired in all but four contracts involving property and cash totalling $190,471.56 (R. 28, 29, 35-109).

After the taxpayer had complied with all of the terms of the respective contracts, it was free to operate the factories in any way it desired or to dispose of them and to retain the proceeds without any obligation to account to the contributing groups (R. 28-30, Exs. 1-A to 16-P, R. 35-109). The Tax Court assumed, and was correct in so doing, that the

---

[1] In this respect the situation is different from that involved in *Frank Holton & Co.*, 10 B.T.A. 1317, decided under the earlier excess profits tax law and relied upon by the Tax Court in the instant case, because in that case title to the property had not passed to the taxpayer and was to be transferred to it only after it had met certain obligations. Such transfer had not taken place on the date which was determinative for the computation of invested capital.

The situation of the taxpayer in the instant case is also different from that involved in *C. L. Downey Co.* v. *Commissioner*, 172 F. (2d) 810, relied upon by the Court of Appeals. There, a Chamber of Commerce had advanced money to the company for which the company executed its note with the understanding that the company would be relieved of the necessity of repayment if it complied with certain stipulated obligations concerning the operation of the factory. These obligations had not been met at the critical date. The company contended for the inclusion of the amount in invested capital as "borrowed capital" under Sections 717 and 719 of the Internal Revenue Code, and not as part of its equity invested capital under Section 718, I.R.C.

taxpayer had fulfilled all conditions attached to the transfers (R. 24).

When received from the community groups, the cash was deposited in taxpayer's general bank account, out of which it paid the cost of constructing the buildings and additions and the cost of the machinery and equipment for the factories in the particular communities. The cash received by the taxpayer from a particular group "was not earmarked for or held intact and applied against the cost of factory, machinery, equipment and other items applicable to the plant acquired or constructed in the particular community". The cash payments when received from the community groups were credited to its earned surplus accounts, either directly or after they had first been credited to contributed surplus. (R. 30, 31, 113, 114.)

The values of the two buildings received from the community groups and used in taxpayer's trade or business, during the taxable years here involved, were set up in the building account on the asset side of its balance sheet and were credited directly to the surplus account on the liability side (R. 30, 31, 114). The parties have stipulated that the bases of the two buildings, for the purpose of inclusion in invested capital and for the computation of depreciation, were $20,251.93 and $65,219.63, respectively (R. 32).

The taxpayer found it necessary to train new employees for employment in the new or enlarged factories in the communities from which it received the contributions. The cost of training such new employees was not less than $100 for each new employee. Before the new or enlarged factories could be operated, the taxpayer had to supply them with an opening inventory of the materials necessary for the manufacturing of shoes. The parties have stipulated the cost of training the new employees, the cost of the opening inventory, the cost of the buildings,

cost of machinery, and the cost of land (in instances where land was purchased) for each of the new or enlarged factories in the communities from which it received the contributions (R. 32, 33, 119).

In every instance the cash which the taxpayer received from the community groups was less than the amount which it expended for the construction of the factory buildings and for machinery and equipment with which to operate the said factories (R. 31). At all times material to the issues in this case, the taxpayer had "accumulated earnings and profits" in excess of $971,031.01 (R. 129).

In computing its excess profits net income for the two taxable years here involved, the taxpayer deducted depreciation on the two buildings received directly from the community groups and also on the full cost of its new and enlarged plants in the communities from which it had received cash contributions. The Commissioner of Internal Revenue disallowed the deduction for depreciation on the two buildings which taxpayer had received directly from the community groups, and he also disallowed an additional amount which he determined to be depreciation on the portion of the buildings, machinery and equipment acquired with cash received from the community groups. The Commissioner also reduced taxpayer's equity invested capital by the amount of $971,031.01, representing the cash and the agreed value of the buildings received from the community groups in question (R. 31, 32).

The Tax Court sustained the Commissioner's determination (a) in reducing taxpayer's equity invested capital by the amount of $971,031.01 on the ground that the said sum did not constitute part of taxpayer's "accumulated earnings and profits" nor part of its invested capital because the transferors were not stockholders (R. 24, 25), and (b) in disallowing depreciation on the two buildings received

directly from the community groups (R. 25). However, the Tax Court held that the Commissioner was not justified in disallowing depreciation on a portion of the cost of the buildings, machinery and equipment constructed or acquired by the taxpayer in the communities from which it had received cash contributions. The Tax Court found that the taxpayer had paid for the said buildings, machinery and equipment out of its own unrestricted funds, and that those items had "cost" to the taxpayer for the purpose of depreciation (R. 25, 26).

Both parties filed petitions for review. On the Commissioner's petition, the Court of Appeals reversed the Tax Court's finding, based upon a stipulation of fact, that the buildings, machinery and equipment constructed or acquired by the taxpayer in the communities from which it had received cash contributions, had "cost" to the taxpayer of the amounts which it had expended therefor, and held that the Tax Court's finding on this point was clearly erroneous within the meaning of Rule 52(a) of the Federal Rules of Civil Procedure (R. 152-155).

On the taxpayer's petition, the Court of Appeals held that the amount of $971,031.01 was not includable in equity invested capital either as "accumulated earnings and profits" or as a "contribution to capital," and also held that the taxpayer was not entitled to depreciation on the two buildings which it had received directly from two of the community groups (R. 155-160).

Specification of Errors to Be Urged

The Court below erred:

1. In holding that the amount of $971,031.01, representing cash and property previously received by the taxpayer from

the community groups, is not includable in taxpayer's equity invested capital as money and property paid in as a "contribution to capital" within the meaning of Section 718(a)(1) and (2), I.R.C.

2. In holding that the said amount of $971,031.01 is not includable in taxpayer's invested capital as part of its "accumulated earnings and profits" within the meaning of Section 718(a)(4), I.R.C.

3. In holding that the taxpayer was not entitled to a deduction for depreciation on the two buildings which it had received directly from two community groups.

4. In setting aside as "clearly erroneous" the findings of the Tax Court to the effect that the taxpayer had a "cost" basis for depreciation equivalent to the total cost of the buildings constructed by it and machinery and equipment acquired by it in the communities from which it had received cash contributions in the aggregate amount of $885,559.45.

5. In holding that the taxpayer's "basis" for depreciation of the buildings constructed by it and the machinery and equipment acquired by it for use in the factories in the communities from which it had received cash contributions, must be reduced by the amount of the cash contributions, as determined by the Commissioner of Internal Revenue.

6. In failing to pass upon taxpayer's alternative contention that if the cash contributions received from the various communities are to be treated, for tax purposes, as a repayment of a portion of taxpayer's cost of starting the factory in the particular community, then the contribution should be allocated not only to the cost of land, buildings, machinery and equipment, but also to the cost of

training new employees and the cost of providing opening inventories with which to operate the factories.[2]

7. In entering judgment for the Commissioner in the two appeals before the Court.

Reasons for Granting the Writ

1. The instant case presents squarely the broad question of the proper treatment, for Federal income and excess profits tax purposes, of contributions received by corporate business enterprises from the Government, or a political subdivision thereof, or community groups, as an inducement to locate and operate a plant or to construct a railway. The number of corporate business enterprises which have received such contributions is large and continues to grow.[3]

These corporations, including railroads which have received a land grant or contributions from communities or community groups, are confronted with a host of unsettled questions in the field of Federal taxation: Whether such money or property is includable in its invested capital; whether property, if of a kind normally subject to depreciation or depletion, may be included in the tax-

---

[2] This contention was raised before the Tax Court (R. 8, 9) but was not decided by that Court since it decided the principal depreciation issue in favor of the taxpayer. It was urged before the Court of Appeals (R. 164) but that Court failed to pass upon it.

[3] This taxpayer alone received not less than seventeen different contributions over a period of twenty-five years (1914-1939) (R. 28, 29). *McKay Products Corporation*, 9 T.C. 1082, involves a like contribution received in 1935, and *C. L. Downey Co.* v. *Commissioner*, 172 F. (2d) 810, involves a transaction of the same general nature entered into in 1941. In the case of railroads, such "donations" are encountered, in the form of land grants or contributions from local communities, so frequently that the Interstate Commerce Commission found it necessary to promulgate rules concerning their accounting treatment. See instructions No. 606 and No. 754, Uniform System of Accounting for Steam Railways, "Accounting Classification", effective January 1, 1942.

payer's basis for depreciation or depletion; whether depreciable property acquired with cash so received or with other cash of its own pursuant to the conditions of the contract with the contributing group is subject to depreciation; and whether a distribution made by such a corporation to its stockholders would constitute a taxable dividend under the provisions of Section 115 of the Internal Revenue Code, if the corporation had no surplus available for distribution other than the surplus created by the contributions here under consideration.

The instant case offers an opportunity for an authoritative decision by this Court on each of these questions.[4] The wide implications of the problems presented by the instant case are indicated by the cases involving various phases of the question, which have already reached the courts, and which reflect the doubts with regard to their proper tax treatment. Whether such contributions were includable in the invested capital of the recipient corporation under the earlier 1918 and 1921 excess profits tax laws was before the United States Board of Tax Appeals in *Frank Holton & Co.*, 10 B. T. A. 1317. A somewhat related question arising out of the same general factual situation was before the United States Court of Appeals for the Eighth Circuit in *C. L. Downey Company* v. *Commissioner*, 172 F. (2d) 810, and questions substantially identical with those involved in the instant case are now pending before the Court of Appeals for the Third Circuit in an appeal from a

[4] A decision in this case, though it does not directly concern the question of whether such a distribution would be a taxable dividend, would supply the answer, since the question turns on "accumulated earnings and profits" within the meaning of Section 115, I.R.C., and since, pursuant to Section 728, I.R.C., the term "accumulated earnings and profits" as used in Section 718(a)(4) has the same meaning as the like term used in Section 115 of the Internal Revenue Code. *Commissioner* v. *South Texas Lumber Co.*, 333 U. S. 496, 500 (footnote 7).

decision of the Tax Court in *McKay Products Corporation*, 9 T. C. 1082. Numerous other cases involving the same basic question are still pending before the Bureau of Internal Revenue, many of which are bound to reach the courts unless the question is finally settled by this Court.

2. In holding that the contributions received by the taxpayer from community groups do not constitute a "contribution to capital" within the meaning of Section 718(a)(1) and (2) of the Internal Revenue Code, the court below has decided an important Federal question in conflict with the decision of this Court in *Edwards* v. *Cuba Railroad Co.*, 268 U. S. 628. In that case, this Court held that subsidies of land, physical property and money paid by the Government of Cuba for the construction of railroads in consideration of which the railroad was to construct a line, reduce certain tariffs and render certain services free of charge, were not income to the railroad company but were contributions to its capital assets. Later, in *Texas & Pacific Railway Co.* v *United States*, 286 U. S. 285, this Court contrasted the payments received by a railroad company under the Transportation Act of 1920 with the contributions received by the taxpayer in the *Cuba Railroad Co.* case, *supra*, stating (p. 289):

> "The sums received under the act [Transportation Act of 1920] were not subsidies or gifts,—that is, *contributions to the capital of the railroads*,—and this fact distinguishes cases such as Edwards v. Cuba R. Co., 268 U. S. 628, where the payments were conditioned upon construction work performed. * * *". (Italics supplied.)

The court below was obviously doubtful of its decision on this point but decided the question against the taxpayer on the ground that it could not say that the decision of the Tax Court was clearly erroneous, stating (R. 160):

> * * * Until the Supreme Court has construed the 1940 Act otherwise we cannot say that the decision of the Tax Court in this regard is clearly erroneous."

When the term "contribution to capital" was introduced into the income tax law by Section 113(a)(8) of the Revenue Act of 1932 (c. 209, 47 Stat. 169),[5] Congress was obviously familiar with the *Cuba Railroad Co.* case, and it can be safely assumed that the term was used in the same sense and that it was intended to apply to contributions such as those involved in the *Cuba Railroad Co.* case. Indeed, it would be difficult to find a more common, and at the same time a better, example of "contributions to capital" than those involved in the *Cuba Railroad Co.* case and in the instant case. It is well established that "unless the contrary appears, statutory words are presumed to be used in the ordinary and usual sense, and with the meaning commonly attributed to them". *DeGanay* v. *Lederer*, 250 U. S. 376, 381. The nature of the contributions which this taxpayer received, and the obligations which it assumed in consideration thereof are substantially identical with those involved in the *Cuba Railroad Co.* case. The decision of the court below is in conflict with the definition of "contribution to capital" as used by this Court in *Edwards* v. *Cuba Railroad Co.*, *supra*, and as that decision was interpreted by this Court in *Texas & Pacific Railway Co.* v. *United States*, *supra*.

3. In approving the Tax Court's holding that contributions such as those involved in the instant case are not includable in invested capital under Section 718(a)(1) and (2) because they were not made by stockholders, the lower

---

[5] The term was used in the corresponding section of succeeding Revenue Acts and of the Internal Revenue Code; in 1940 it was introduced in the excess profits tax law of 1940 (Section 718(a)(1) and (2), I.R.C.). See Appendix, *infra*, pages 23, 24, 27, 28.

court has nullified the Commissioner's definition of the term "contribution to capital" in Regulations which under well established principles must be regarded as having received Congressional approval.

The Tax Court held that the contributions here involved did not become part of equity invested capital under Section 718(a)(1) or (2) because the transferors were not stockholders (R. 25).

The Court of Appeals for the Eighth Circuit pointed out that the Tax Court's decision in this regard was consistent with the decision of this Court in *LaBelle Iron Works* v. *United States*, 256 U. S. 377, decided under the 1917 Act, and upheld the Tax Court because it could not say that the decision of the Tax Court in this regard was clearly erroneous. The definition of invested capital under the 1917 Act was entirely different from the definition of invested capital under the Second Revenue Act of 1940. In the 1917 Act, invested capital was defined as "(1) actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation * * * and (3) paid-in or earned surplus and undivided profits used or employed in the business, * * *" (1917 Revenue Act, Sec. 207(a); c. 63, 40 Stat. 300).[6]

That definition of invested capital was changed in Section 718 (a)(1), (2) and (4) of the Internal Revenue Code[7] to include money or property "paid in for stock, or as paid in surplus, or *as a contribution to capital*"; plus the accumulated earnings and profits as of the beginning of the taxable year.[8] As previously mentioned (p. 12 *supra*),

---

[6] The definition of invested capital in Section 326(a) of the 1918 and 1921 Revenue Acts (c. 18, 40 Stat. 1057; c. 136, 42 Stat. 227) was substantially the same as the definition in the 1917 Act.

[7] The text of these provisions is set out in the Appendix, *infra*, pp. 26-28.

[8] It also provided, for the first time, for the inclusion, in invested capital, of borrowed capital. Sections 717, 719, I.R.C.

the term "contribution to capital", when first used by Congress as a component of equity invested capital in the Second Revenue Act of 1940, had a well defined meaning in the income tax law and regulations. It had been used in the income tax law itself for a period of eight years, and had been defined in the Commissioner's income tax regulations for a period of more than six years. The clear meaning of the term as defined in the Commissioner's income tax regulations was money or property contributed to the corporation by "any person"—not only a shareholder. Reenactment of the statute without disapproval of regulations thereunder gives the regulations added sanction.[9]

The term was first introduced in income tax law as a part of Section 113(a)(8) of the Revenue Act of 1932 and has been retained in each succeeding revenue act and in the corresponding section of the Internal Revenue Code up to the present time.

The Commissioner defined the term in Income Tax Regulations 86 (Article 113(a)(8)-1), promulgated under the Revenue Act of 1934, as follows:

> "In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, *or from any person as a contribution to capital*, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift, the basis thereof shall be determined under section 113(a)(2)." (Italics supplied.)

The above provision has been included in all of the subsequent income tax regulations, including the present Regu-

[9] *Commissioner* v. *Wheeler*, 324 U. S. 542, 547 (footnote 10).

lations 111, as an interpretation of Section 113(a)(8) of the law.[10]

The excess profits tax Regulations 109 and 112, promulgated by the Commissioner under the excess profits tax act of 1940,[11] contained a definition of the term "contribution to capital" practically identical with the definition contained in the income tax regulations. Sections 30.718-1, and 35.718-1).[12]

The holding of the Tax Court, as approved by the Court of Appeals, that the contributions here involved do not constitute part of taxpayer's equity invested capital because they were not made by stockholders, is counter to and nullifies these provisions of the Commissioner's regulations. This situation will necessarily result in great confusion in the administration of Section 113(a)(8) and will lead to additional litigation unless the question of what constitutes, and who can make, a contribution to capital is decided by this Court.[13]

---

[10] Regulations 94 (Article 113(a)(8)-1), promulgated under the Revenue Act of 1936; Regulations 101 (Article 113(a)(8)-1), promulgated under the Revenue Act of 1938; Regulations 103 (Sec. 19.113(a)(8)-1) and Regulations 111 (Sec. 29.113(a)(8)-1), promulgated under the Internal Revenue Code, the latter Regulations being applicable to all taxable years beginning after December 31, 1941.

[11] Applicable, respectively, to taxable years beginning prior to, and after, December 31, 1941.

[12] The text of these provisions is set out in the Appendix, *infra*, pp. 30-31.

[13] The excess profits tax law of 1940 having been passed "to tax abnormally high profits due to large governmental expenditures about to be made from appropriations for national defense" (*Commissioner* v. *South Texas Lumber Co.*, *supra*, at 497), the result reached by the courts below is incongruous because it subjects to excess profits tax, gains which have nothing whatsoever to do with war profits or abnormally high profits, and which, indeed, are normal profits. By eliminating the contributions of $971,031.01 from taxpayer's invested capital, the courts below have reduced what Congress deemed to be a taxpayer's "fair and normal return for the corporation business taxed". (*Commissioner* v. *South Texas Lumber Co.*, *supra*, at 497). Here, such "fair and normal return" was

4. The question of whether contributions of the nature of those here involved constitute "accumulated earnings and profits" within the meaning of Section 718(a)(4), I.R.C., irrespective of whether or not they constituted taxable income at the time of their receipt, is of great practical importance for the purpose of determining invested capital under the recent excess profits tax law and, as well, "earnings and profits" available for distribution of dividends under Section 115(a), I.R.C. Although this Court had repeatedly dealt with "earnings and profits", the cases always concerned rather narrowly defined aspects, and in none of the cases, so far as we have found, was the question squarely presented, as does the instant case, of what constitutes earnings and profits, and in particular, of whether items not subject to income tax are includable in "earnings and profits".[14] This Court has dealt, for instance, with questions concerning the tax treatment of pre-March 1, 1913, accumulations;[15] with distributions in con-

---

represented by a percentage of its invested capital, and the smaller the invested capital; the smaller is the amount deductible from the net income as excess profits credit.

If the taxpayer had computed its excess profits tax by the use of the excess profits credit based on income, such credit would be measured by the earnings during the base period years from all of its assets, *no matter from whom received*. Congress obviously did not intend to discriminate against taxpayers using the invested capital method. It seems reasonable to conclude that under either method all "working capital" was to be used in determining the standard of normal earnings. In the *South Texas Lumber Co.* case (at pages 497, 498) this Court stated:

> "It thus appears that by this [invested capital] method Congress intended, with minor exceptions not here relevant, to impose the excess profits tax on all annual net income in excess of 8% of a corporation's working capital • • •"

[14] The record fails to indicate whether the taxpayer was taxed on the contributions here involved. The courts below assumed that they were not taxable income in taxpayer's hand, and the taxpayer does not contend to the contrary. The entire amount was received subsequent to March 1, 1913, so that no problem of a pre-March 1, 1913 accumulation is involved.

[15] *Lynch* v. *Hornby*, 247 U. S. 339; *Peabody* v. *Eisner*, 247 U. S. 347; *Heivering* v. *Canfield*, 291 U. S. 163; and *Foster* v. *United States*, 303 U. S. 118.

nection with liquidations [16] and reorganizations; [17] with earnings and profits of a corporation reporting income on the installment basis,[18] and with the question of whether a dividend was distributed out of profits of the year 1917 or an earlier year.[19]

In holding that its decision was controlled by *Commissioner* v. *South Texas Lumber Co.*, *supra* (R. 157-158), the lower court failed to appreciate that that case is limited to corporations reporting on the installment basis under Section 44 of the Internal Revenue Code and the regulations promulgated thereunder, and that the validity of those regulations was "the crucial question" (333 U. S. at p. 500). However, that case did not hold that an item must have constituted taxable income in order to be includable in "earnings and profits."

The lower court's holding that the amount of $971,031.01 was not includable in taxpayer's "earnings and profits" because it had not been included in taxable income in the years of receipt, has in effect nullified Section 29.115-3 of Regulations 111 and corresponding section of the earlier regulations.[20] That regulation promulgated under Section 115 of the Internal Revenue Code specifically provides that "earnings and profits" of a corporation include "all income exempted by Statute, income not taxable by the Federal government under the Constitution, * * * interest on State bonds and certain other obligations although not taxable when received by a corporation * * *". The effect of the lower court's decision on this point is to exclude from the

[16] *Lynch* v. *Turrish*, 247 U. S. 221; *Commissioner* v. *Wheeler*, 324 U. S. 542.

[17] *Commissioner* v. *Bedford*, 325 U. S. 283; *Commissioner* v. *Munter*, 331 U. S. 210; *Commissioner* v. *Phipps*, 336 U. S. 410; several of those cases involve the application of the Sansome rule (60 F. (2d) 931).

[18] *Commissioner* v. *South Texas Lumber Co.*, supra.

[19] *Edwards* v. *Douglas*, 269 U. S. 204.

[20] The text of these sections is set out in Appendix, *infra*, pp. 29, 30.

invested capital of a corporation all exempt income included in its accumulated earnings and profits. Likewise, it would have the effect of excluding surplus created by the receipt of such exempt income or contributions of the nature here involved from taxable dividends when distributed to the shareholders of the corporation.

If such items are not part of accumulated earnings and profits under Section 718(a)(4), which by Section 728, I.R.C., is given the same meaning as earnings and profits under Section 115 of the Internal Revenue Code,[21] they would not constitute taxable income to the stockholders when distributed. Thus, in excluding such items from earnings and profits in order to eliminate them from invested capital for the relatively short period of the second excess profits tax, the lower court has set a precedent which would exempt from tax for the indefinite future all such items when the surplus created by their receipt is distributed to the shareholders.

Early in the history of the present income tax law, this Court established a broad meaning for "dividends," as "the appropriate fruit of stock ownership . . . commonly reckoned as income," without regard to whether they are declared "from the most recent earnings, or from surplus accumulated from the earnings of the past or are based upon the increased value of the property of the corporation."[22] The holding of the court below would tend to narrow the concept of "earnings and profits" and, therefore, of taxable dividends. A decision of this Court on this ques-

---

[21] See Sec. 35.718-2 of Treasury Regulations 112 (Appendix, *infra*, p. 31). Under the law of the State of New York, the state in which the taxpayer is incorporated (Section 58 of the Stock Corporation Law, Appendix, *infra*, p. 31), the taxpayer would have been free to distribute the surplus created by the receipt of the contributions in question if its Board of Directors had desired to do so. *Randall* v. *Bailey*, 23 N.Y.S. (2d) 173; affirmed, 288 N.Y. 280, 43 N.E. (2d) 43.

[22] *Lynch* v. *Hornby*, 247 U. S. 339, 344.

tion would be of great practical importance in the administration of the internal revenue laws, and would forestall much future litigation.

5. The decision of the lower courts on the depreciation issues presented in this case and in other cases involving the right of the taxpayer to deduct depreciation on property directly contributed by a community group or purchased with money contributed by such a group, reflects the extreme confusion existing on the subject. The instant case presents squarely the depreciation issues arising out of such a situation and is, therefore, an appropriate one in which this Court could finally resolve the doubts and obviate much future litigation.

Although the facts in the instant case are clearly different from the facts in *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, the lower courts have relied mainly on that case, in deciding the depreciation questions. The contributors toward the cost of the extensions in the *Detroit Edison* case were making payments in exchange for a direct personal benefit—namely, the extension of the line to the home or place of business of the particular contributor. After the extension had been made, he had a continuing interest in it, and the utility company was not free to discontinue the service. This Court held that the payments made to the Detroit Edison Company by the prospective users were not gifts or contributions to capital, but that they "were to the customer the price of the service." Consequently, those payments which had not been taxed as income reduced the cost of the extension to the utility company for depreciation purposes.

On the other hand, neither the community group nor its individual members expect or receive any direct benefit. They make the contribution for the benefit of the entire community, because by attracting a new enterprise

or inducing an existing one to enlarge its operations, the community group secures a source of additional employment for the population of that particular community.

Every court which had occasion to pass on the depreciation issues of the kind here involved, has held that no depreciation could be taken on property contributed by a community group to a taxpayer, and with one exception, every court has held that in determining the basis for depreciation, a taxpayer's cost had to be reduced by the cash received from community groups. The only exception was the holding of the Tax Court in the instant case. Although disallowing depreciation on the two contributed buildings, the Tax Court (R. 25, 26) found that this taxpayer could deduct depreciation on buildings, machinery and equipment, that their cost was what it had expended for these items, and that the basis for depreciation should not be reduced by the amount of the cash contributions received from community groups. However, this finding, though plainly justified by the record (Stipulations 9, 11, R. 30 to 32), was reversed by the Court of Appeals as being "clearly erroneous." The Court relied on a condition found in some, but not all, of the contracts with the community groups that the cash contributed was to be used for the payment of a factory building and the equipment (R. 154). However, the Court overlooked the fact that in one instance there was no contract and, consequently, no condition of any sort; that in other instances there was no condition that the money be used for the construction and equipment of a factory, and that in all instances where the contracts contained such a condition, they also required the taxpayer to do many other things. It is significant that the same Judge of the Tax Court (Judge Murdock), who made the finding in the taxpayer's case, made an opposite finding in the case of *C. L. Downey Company*, 10 T. C. 837.

where a Chamber of Commerce had paid that taxpayer money to be applied toward the construction of a plant in the particular community. In that case, he found that the money received from the Chamber of Commerce was not part of the basis for depreciation of the plant in question.

The *Downey* decision was affirmed in *C. L. Downey Co. v. Commissioner*, 172 F.(2d) 810, on the ground that depreciation "is allowable only on the cost to the taxpayer of property," ignoring completely the exceptions to the use of the cost basis, enumerated in Section 113(a), I.R.C. In *McKay Products Corporation*, 9 T.C. 1082, the Tax Court stated that the buildings received by that taxpayer did not constitute a gift under Section 113(a)(2), I.R.C., and, consequently, had no basis for purposes of depreciation.

The effect of the decisions of the lower courts is to nullify completely the provisions of Section 113(a)(2) and Section 113(a)(8)(B), I.R.C., which provide that a taxpayer may use the basis of the transferor where property is received as a gift or as a contribution to capital. They reached that conclusion by construing the decision of this Court in the *Detroit-Edison Company* case as if it had abrogated every subparagraph of Section 113(a) and had held that cost to the taxpayer is the only basis for depreciation. The same construction is being applied by the Bureau of Internal Revenue.

If the contributions in the instant case were received as "contributions to capital", as the taxpayer contends, then the taxpayer is entitled to the transferor's basis for the purpose of computing depreciation—otherwise, Section 113(a)(8)(B) is meaningless. The transferor's basis in the case of the two buildings received directly from the community groups has been stipulated and the cash received directly from the community groups has a "basis" in the hands of the transferor equivalent to the cash received.

An authoritative decision by this Court on the depreciation questions involved in the instant case would dispel the confusion now existing in the minds of taxpayers and, as well, the lower courts; would aid in the administration of the tax laws, and would avoid much future litigation.

Conclusion

The decision below is wrong; it invalidates in effect two provisions of the Treasury regulations; it is in conflict with decisions of this Court; and it involves questions which are recurring and of great importance in the administration of the federal tax laws. For the foregoing reasons, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

CHARLES B. MCINNIS,
Mayflower Office Building,
Washington 6, D. C.,
Counsel for Petitioner.

Of Counsel:

ERNEST M. CALLOMON,
ROBERTS & MCINNIS,
Mayflower Office Building,
Washington 6, D. C.

APPENDIX

Statutes and Regulations Applicable During the Taxable Years Ending October 31, 1942, and October 31, 1943.

Internal Revenue Code:

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

* * * * * * * * *

(l) [as amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business . . .

* * * * * * * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that —. . .

* * * * * * * *

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section

112(b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined upon subsection (a), adjusted as hereinafter provided.

* * * * * * *

(26 U.S.C. 1946 ed., Sec. 113)

Sec. 114. Basis for Depreciation and Depletion.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * * * *

(26 U.S.C. 1946 ed., Sec. 114.)

Sec. 115. Distributions by Corporations.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter . . . means any distribution made by a corporation to its shareholders, whether in

money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made . . .

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113 . . .

. . . . . .

Sec. 712. Excess Profits Credit—Allowance [Added by Sec. 201, 2nd 1940 Act; amended by Sec. 13, Excess Profits Tax Amendments of 1941].

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess profits credit in case of certain reorganizations of corporations, see section 741.)

. . . . . .

(26 U.S.C. 1946 ed., sec. 712(a))

Sec. 714. Excess Profits Credit—Based on Invested Capital.

The excess profits credit, for any taxable year, computed under this section, shall be the amount shown in the following table:

If the invested capital for the taxable year, determined under section 715, is:	The credit shall be:
Not over $5,000,000	8% of the invested capital
Over $5,000,000	$400,000, plus 7% of the excess over $5,000,000.

(as in force during fiscal year ended October 31, 1942)

Sec. 714. Excess Profits Credit—Based on Invested Capital. [as amended by Section 217, Revenue Act of 1942]

The excess profits credit, for any taxable year, computed under this section, shall be the amount shown in the following table:

If the invested capital for the taxable year, determined under section 715, is:	The credit shall be:
Not over $5,000,000	8% of the invested capital.
Over $5,000,000, but not over $10,000,000	$400,000, plus 7% of the excess over $5,000,000.
Over $10,000,000, but not over $200,000,000	$750,000, plus 6% of the excess over $10,000,000.
Over $200,000,000	$12,150,000, plus 5% of the excess over $200,000,000.

(as in force during fiscal year ended October 31, 1943)

Sec. 718. [As added by Sec. 201, Second Revenue Act of 1940, supra] Equity Invested Capital.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b),—

(1) *Money Paid In.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) *Property Paid In.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined in the same manner as if the property were still held at the beginning of such taxable year. If such unadjusted basis is a substituted basis it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113(b)(2);

* * * * * * *

(4) *Earnings and Profits at Beginning of Year.*—The accumulated earnings and profits as of the beginning of such taxable year;

* * * * * * *

(as in force during fiscal year ended October 31, 1942)

Sec. 718. [As added by Sec. 201, Second Revenue Act of 1940, supra] Equity Invested Capital.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money Paid In.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) [as amended by Sec. 218, Revenue Act of 1942, c. 619, 56 Stat. 798] *Property Paid In.*—Property

(other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115(l) for determining earnings and profits;

* * * * * * *

(4) *Earnings and Profits at Beginning of Year.*— The accumulated earnings and profits as of the beginning of such taxable year;

* * * * * * *

(as in force during fiscal year ended October 31, 1943)

Sec. 728. Meaning of Terms Used [Added by Sec. 201, 2nd 1940 Act].

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

TREASURY REGULATIONS

Treasury Regulations 103, issued under the Internal Revenue Code, as in effect during the taxable year ended October 31, 1942:

Sec. 19.113(a)(8)-1.[23] *Property acquired by a corporation after December 31, 1920.*— . . .

[23] Section 29.113(a)(8)-1 of Treasury Regulations 111, promulgated under the Internal Revenue Code, as in effect during the taxable year ended October 31, 1943, is identical with Section 19.113(a)(8)-1 of Regulations 103.

In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, or from any person as a contribution to capital, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift the basis thereof shall be determined under section 113(a)(2).

* * * * * * * * *

Sec. 19.115-3. *Earnings or Profits.*—In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive. Among the items entering into the computation of corporate earnings or profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22(a) or corresponding provisions of prior Revenue Acts. Gains and losses within the purview of section 112 or corresponding provisions of prior Revenue Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section. Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

easury Regulations 111, promulgated under the Internal venue Code, as in effect during the taxable year ended tober 31, 1943:

Sec. 29.115-3. *Earnings or Profits.*—In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be con-

clusive, the amount of the earnings or profits in any case will be dependent upon the method of accounting properly employed in computing net income. For instance a corporation keeping its books and filing its income tax returns under sections 41, 42, and 43 on the cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation computing income on the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis; and an insurance company subject to taxation under section 204 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 204(b)(5) and which is segregated accordingly in the unearned premium reserve.

Among the items entering into the computation of corporate earnings or profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22(a) or corresponding provisions of prior Revenue Acts. Gains and losses within the purview of section 112 or corresponding provisions of prior Revenue Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section (see section 29.115-12). Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

Treasury Regulations 109, promulgated under the Internal Revenue Code, as in force during the taxable year ended October 31, 1942:

Sec. 30.718-1.[24] *Determination of daily equity invested capital—Money and property paid in.*— . . .

---

[24] Section 35.718-1 of Treasury Regulations 112, promulgated under the Internal Revenue Code, as in force during the taxable year ended October 1, 1943, is identical with Section 30.718-1 of Regulations 109.

If the property was acquired after December 31, 1920, by a corporation from a shareholder as paid-in surplus or from any person as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made. (See section 113(a)(8).)

Sec. 30.718-2. *Determination of daily equity invested capital—Accumulated earnings and profits*—(a) *In general.*—The term "accumulated earnings and profits" is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and section 30.718-4 as to the effect of the declaration and distribution of dividends. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax. . . .

Treasury Regulations 112, promulgated under the Internal Revenue Code, as in force during the taxable year ended October 31, 1943:

Sec. 35.718-2. *Determination of Daily Equity Invested Capital—Accumulated Earnings and Profits.*—(a) *In general.*—The term "accumulated earnings and profits" is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and section 35.718-5 as to the effect of the declaration and distribution of dividends. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax. . . .

NEW YORK STOCK CORPORATION LAW

Section 58 of the Stock Corporation Law of the State of New York, as amended in 1938 and 1939 c. 59 of the Consolidated Laws of New York:

No stock corporation shall declare or pay any dividend which shall impair its capital, nor while its capital

is impaired, nor shall any such corporation declare or pay any dividend or make any distribution of assets to any of its stockholders, whether upon reduction of the number or par value of its shares or of its capital, unless the value of its assets remaining after the payment of such dividend, or after such distribution of assets, as the case may be, shall be at least equal to the aggregate amount of its debts and liabilities, including capital.

(5030)

LIBRARY
SUPREME COURT U.S.

Office - Supreme Court, U. S.
FILED
MAR 17 1950
CHARLES ELMORE CROPLEY

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

CHARLES B. MCINNIS,
ERNEST M. CALLOMON,
Mayflower Office Building,
Washington 6, D. C.,
Attorneys for Petitioner.

Of Counsel:
ROBERTS & MCINNIS,
Mayflower Office Building,
Washington 6, D. C.

INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	2
Specifications of errors to be urged	9
Summary of argument:	
I. The invested capital issues	11
II. The depreciation issues	13
Argument:	
I. The invested capital issues	14
(1) The contributions to petitioner in cash and property other than cash in the aggregate amount of $971,031.01 represent "contributions to capital" and are includable in petitioner's equity invested capital under the provisions of Section 718(a)(1) and (2) of the Internal Revenue Code	14
(a) The decisions under the World War I Excess Profits Tax relied upon by the courts below are not applicable to this case arising under the World War II Excess Profits Tax because the two acts define "invested capital" differently	17
(b) The Commissioner's regulations in effect at the time of the adoption of, and those promulgated by him under, the World War II Excess Profits Tax recognize that a "contribution to capital" may be received from "any person."	22

Page

(c) The courts and authors of legal and accounting texts regard contributions of the nature of those here involved as "contributions to capital." 26

(d) The inclusion of the amounts here involved in petitioner's equity invested capital as contributions to capital is consistent with the general scheme of the World War II Excess Profits Tax 33

(2) If the contributions in the amount of $971,031.01 are not includable in petitioner's invested capital as a "contribution to capital," then they are includable in its "accumulated earnings and profits" as of the beginning of the taxable years here involved pursuant to Section 718(a)(4), I.R.C. 36

(a) The term "accumulated earnings and profits," which has the same meaning for both excess profits tax and income tax purposes, is not limited to amounts which have been previously included in taxable income 39

(b) The surplus created by the receipt of the contributions in the amount of $971,031.01 was available for and could be distributed as dividends by petitioner 50

(c) Since any distribution of the surplus created by the receipt of the contributions in the amount of $971,031.01 would constitute a taxable dividend to petitioner's stockholders, the amount is part of petitioner's "earnings and profits," and is includable in its invested capital 52

Page

II. The depreciation issues 55

(1) The contributions of cash and property other than cash in the aggregate amount of $971,031.01 should not be eliminated from petitioner's "basis" for depreciation because petitioner is entitled to the "substituted basis" provided by Section 113, I.R.C. 55

(2) The court below was not justified in setting aside as "clearly erroneous" the finding of the Tax Court that the buildings and machinery were paid out of petitioner's own unrestricted funds and that such buildings and machinery had a "cost" basis to petitioner 62

(3) If the cash contributions are to be used to reduce petitioner's basis for depreciation, such contributions should be allocated not only to the cost of land, buildings and machinery but also to the cost of training new employees and the cost of providing opening inventory with which to operate the new or enlarged factories 65

onclusion 66

APPENDIX

ternal Revenue Code

Section 23(l) 67
Section 23(n) 67
Section 113(a)(2) 67
Section 113(a)(8) 68
Section 113(b)(2) 68
Section 114(a) 69
Section 115(a), (b) 69, 70
Section 115(l), (m) 70, 71
Section 712(a) 72
Section 714 72

Page

Section 714, as amended 73
Section 717 73
Section 718(a)(1), (2), (4) 74
Section 718(a)(1), (2), (4), as amended 74
Section 719 75
Section 728 76
Treasury Regulations
Regulations 103, Section 19.113(a)(8)-1 76
Regulations 111, Section 29.113(a)(8)-1 76
Regulations 103, Section 19.115-3 76
Regulations 111, Section 29.115-3 77
Regulations 109, Section 30.718-1, -2 78
Regulations 112, Section 35.718-1 78
Regulations 109, Section 30.718-2 78
Regulations 112, Section 35.718-2 79
G.C.M. 16952 (Cumulative Bulletin 1937-1, p. 133) 79
New York Stock Corporation Law, Section 58 83

Cases Cited

Ayer, Charles F., 12 B.T.A. 284 43
Brewster v. *Gage*, 280 U. S. 327 24
Burke v. *Southern Pacific Railroad Co.*, 234 U. S. 669 52
C. L. Downey Co., 10 T. C. 837, aff'd. 172 F. 2d 810 5, 63
Commissioner v. *Bedford*, 325 U. S. 283 42
Commissioner v. *Fisher*, 327 U. S. 512 42
Commissioner v. *F. J. Young Corporation*, 103 F. 2d 137 48
Commissioner v. *McKay Products Corporation*, 178 F. 2d 639 26, 33, 34, 36, 60, 61
Commissioner v. *Munter*, 331 U. S. 210 42
Commissioner v. *Phipps*, 336 U. S. 410 42, 53
Commissioner v. *South Texas Lumber Co.*, 333 U. S. 496 22, 34, 37, 38, 39, 42, 49
Commissioner v. *Wheeler*, 324 U. S. 542 25, 42, 48
Commissioner v. *Wilcox*, 327 U. S. 404 51
Cummings v. *Commissioner*, 73 F. 2d 477 44, 46, 53
Currier, Charles B., et ux., 7 T. C. 980 60
Detroit Edison Co. v. *Commissioner*, 319 U. S. 98 15, 59, 60

	Page
Edward v. *Cuba Railroad Co.*, 268 U. S. 628	27, 28, 30, 31, 52, 63
Edwards v. *Douglas*, 269 U. S. 204	42
Fawcus Machine Co. v. *United States*, 282 U. S. 375	24
Foster v. *United States*, 303 U. S. 118	42
Frank Holton & Co., 10 B.T.A. 1317	4, 17, 19, 22, 59
Golden v. *Commissioner*, 113 F. 2d 590	45, 53
Helvering v. *Canfield*, 291 U. S. 163	42
Helvering v. *Claiborne-Annapolis Ferry Co.*, 93 F. 2d 875	29
Helvering v. *Taylor*, 293 U. S. 507	31
La Belle Iron Works v. *United States*, 256 U. S. 377	17, 19, 21, 22
Liberty Mirror Works, 3 T. C. 1018	17
Louisville & Nashville R. R. Co. v. *United States*, 267 U. S. 395	52
Lykes Bros. Steamship Co., Inc., 42 B.T.A. 1395, aff'd. 126 F. 2d 725	29, 52
Lynch v. *Hornby*, 247 U. S. 339	42
Lynch v. *Turrish*, 247 U. S. 221	42
McKay Products Corporation, 9 T. C. 1082	17
North American Oil Consolidated v. *Burnet*, 286 U. S. 417	51
Peabody v. *Eisner*, 247 U. S. 347	42
Randell v. *Bailey*, 23 N. Y. S. (2d) 173, aff'd. 288 N. Y. 280, 43 N. E. (2d) 43 (1942)	51
Rice v. *Eisner*, 16 F. 2d 358	46
Rosenbloom Finance Corporation v. *Commissioner*, 24 B.T.A. 763, aff'd. 66 F. 2d 556; cert. denied 290 U. S. 692	47, 58
Schweppe, Annis Van Nuys, 8 T. C. 1224, aff'd. per curiam 168 F. 2d 284	47
Texas & Pacific Railway Co. v. *United States*, 286 U. S. 285	28, 52
United States v. *Oregon-Washington R. & Navigation Company*, 251 Fed. 211	46
United States v. *Yellow Cab Company*, — U. S. — (December 5, 1949)	64
Willcutts v. *Milton Dairy Company*, 275 U. S. 215	50

STATUTES CITED

	Page
Federal Rules of Civil Procedure: Rule 52(a)	9, 56, 63
Revenue Act of 1917, 40 Stat. 300, c. 63	11, 18, 19
Revenue Act of 1918, 40 Stat. 1057, c. 18	11, 18
Revenue Act of 1921, 42 Stat. 227, c. 136	11, 18, 58
Revenue Act of 1924, 43 Stat. 253, c. 234	58
Revenue Act of 1928, 45 Stat. 791, c. 852	41, 44
Revenue Act of 1932, 47 Stat. 169, c. 209	12, 23, 28, 41, 58
Revenue Act of 1934, 48 Stat. 680, c. 277	24, 29, 41
Revenue Act of 1936, 49 Stat. 1648, c. 690	24, 41
Revenue Act of 1938, 52 Stat. 447, c. 289	24, 41
Internal Revenue Code:	
Subchapter E	11, 12, 23, 39
Sec. 22	41, 44
Sec. 23	56
Sec. 44	37
Sec. 112	43, 48
Sec. 113	6, 8, 13, 14, 23, 24, 29, 55, 56, 57, 58, 59, 60, 62
Sec. 114	9, 56
Sec. 115	13, 41, 46, 47, 48, 53, 54
Sec. 712	16
Sec. 713	21
Sec. 714	21
Sec. 717	5, 20
Sec. 718 (a)	2, 5, 9, 10, 14, 20, 22, 23, 25, 26, 29, 32, 35, 36, 38, 39, 40, 54
Sec. 719	5, 34
Sec. 728	23, 39
Sec. 3797 (a)	25
Second Revenue Act of 1940, 54 Stat. 974, c. 757,	9, 16, 19, 23, 40, 48
Stock Corporation Law of New York (Chapter 59, Consolidated Laws, as amended), section 58	51
U. S. Code, Title 28, Sec. 1254	2

MISCELLANEOUS

Financial Handbook, edited by Jules I. Bogen, 3d Ed. (1948)	31
G. C. M. 16952 (C.B. 1937-1, p. 133)	27, 38

Page

Harvey, *Some Indicia of Capital Transfers Under the Federal Income Tax Laws* (1939) 37 Mich. L. Rev. 745 31

House of Representatives Report No. 708, 72nd Congress, 1st Session, p. 21 58

House of Representatives Report No. 1492, 72nd Congress, 1st Session, p. 13 58

House of Representatives Report No. 2894 (C.B. 1940-2, p. 496, 526) 48

I. T. 1924, Cumulative Bulletin III-1, p. 27 47, 53

Joint Hearings before the Committee on Ways and Means, House of Representatives, and Committee on Finance, United States Senate, 76th Congress, 3rd Session, p. 94 40

Magill, *Taxable Income*, Revised Edition 1945, pp. 387 to 392 30

Marple, *Capital Surplus and Corporate Net Worth* (1936) 31

Mertens, *Law of Federal Income Taxation*, Vol. 3, Vol. 7A 54, 58

Montgomery's Federal Taxes on Corporations (1945-46), Vol. 2 55

O'Meara, *Contributions to Capital by Nonshareholders* (1948) 3 Tax Law Review 568 31

Senate Report No. 665, 72nd Congress, 1st Session, pp. 27, 28 58

Treasury Regulations 45 (1920 ed.) 19, 25

Treasury Regulations 62 (1922 ed.) 19, 25

Treasury Regulations 86 24

Treasury Regulations 94 24

Treasury Regulations 101 24

Treasury Regulations 103 24

Treasury Regulations 109 25

Treasury Regulations 111 19, 24, 25, 38, 42

Treasury Regulations 112 19, 25, 39, 43

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

Opinions Below

The opinion of the Tax Court of the United States (R. 23-26) is reported in 10 T.C. 291. The opinion of the Court of Appeals for the Eighth Circuit (R. 149-160) is reported in 175 F. 2d 305.

Jurisdiction

The judgment of the Court of Appeals was entered on June 17, 1949 (R. 161). The petition for rehearing of the petitioner, filed on August 1, 1949 (R. 163-166), was denied on August 8, 1949 (R. 167). The petition for a writ of *certiorari* was filed on November 5, 1949, and granted on

January 9, 1950 (R. 168). The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254.

Questions Presented

1. Whether the amount of $971,031.01, representing the total amount of cash and property other than cash contributed to the petitioner by certain community groups as an inducement to locate a new plant or to enlarge an existing plant in the particular community, is includable in petitioner's equity invested capital, either as a "contribution to capital" under Section 718(a)(1) and (2) of the Internal Revenue Code, or as part of petitioner's "accumulated earnings and profits" under Section 718(a)(4) thereof.

2. Whether the cash in the amount of $885,559.45, or any part thereof, received by the petitioner from the community groups and deposited in its unrestricted bank account, reduces the petitioner's "basis" for depreciation of buildings, machinery and equipment constructed or acquired by the petitioner in the respective communities.

3. Whether the petitioner is entitled to deduct depreciation on the two factory buildings which it received directly from two of the community groups, the said buildings having stipulated bases of $20,251.93 and $65,219.63, respectively.

Statutes and Regulations Involved

The statute and regulations involved are set out in the Appendix, *infra*, pp. 67 to 83.

Statement

This proceeding involves deficiencies in petitioner's excess profits tax for the fiscal years ending October 31, 1942, and October 31, 1943. The facts were stipulated

(R. 27-34), and were found by the Tax Court (R. 23-26). So far as material here, they may be summarized as follows:

The petitioner is a New York corporation, having its principal place of business in St. Louis, Missouri. At all times material here, the petitioner was engaged in the manufacture and sale at wholesale of men's, women's and children's shoes and conducted its manufacturing operations in a number of different plants located in Missouri, Illinois, Indiana, and Tennessee (R. 27-28).

During the years 1914 to 1939, inclusive, the petitioner received $885,559.45 in cash and $85,471.56 (stipulated basis) in buildings from various community groups as an inducement to locate a new plant, or to enlarge an existing plant in the particular community, the total amounting to $971031.01 (R. 24, 28-29)

In one instance involving the payment to petitioner of $10,000.00 cash, there was no contract between the community group and the petitioner. The minutes of the meeting of petitioner's Board of Directors merely state that a "bonus" of $10,000.00 had been paid "as a part of our organization expenses in starting the factory" in Dixon, Illinois (R. 28).

In all of the sixteen other instances, there were contracts between the petitioner and the respective community groups.[1] These contracts varied but generally required the petitioner to construct or acquire a factory, or to enlarge an existing factory in the particular community, operate it for an agreed period of time,[2] meet a specified

[1] Copies of the contracts are attached to the Stipulation marked Exhibits 1-A to 16-P, inclusive (R. 35-109).

[2] Four contracts—namely, those with the Chamber of Commerce and the People of Charleston, Illinois, Exhibit 2-B (R. 39); the Salem Chamber of Commerce, Salem, Illinois, Exhibit 7-G (R. 69); the Chamber of Commerce of Litchfield, Illinois, Exhibit 8-H (R. 71, 73); and the Citizens of Pittsfield, Illinois, Exhibit 13-M (R. 99) did not specify any period of time.

payroll during the agreed period of time and employ a stipulated number of employees (R. 35-107).

In ten instances the amount was to be refunded, or the factory building acquired in the particular community was to be transferred to the particular community group if the petitioner discontinued operations in the particular community prior to the expiration of the specified time.[3]

In six instances the agreements between petitioner and the respective community groups contain no obligation for any repayment of the funds, or transfer of the property.[4]

In all instances the money or property involved was transferred or paid over to the petitioner outright.[5] In five

---

[3] Contract with citizens of the city of Charleston, Illinois, Exhibit 1-A (R. 35-37); Contract with citizens of the city of Mattoon, Illinois, Exhibit 4-D (R. 49-51-53); Contract with Chamber of Commerce of Union City, Tennessee, Exhibit 5-E (R. 55-57-59-61-63); Contract with citizens of the city of Salem, Illinois, Exhibit 6-F (R. 65-67); Contract with citizens of the city of Vincennes, Indiana, Exhibit 9-I (R. 75-77); Contract with the Board of Trustees of the Moberly Industrial Foundation for and in behalf of the citizens of Moberly, Missouri, Exhibit 10-J (R. 79-81-83); Contract with the Sullivan Community Club on behalf of the citizens of the city of Sullivan, Illinois, Exhibit 11-K (R. 85-87-89-91-93); Contract with Pittsfield Development Association of Pittsfield, Illinois, Exhibit 12-L (R. 95-97); Contract with citizens of the city of Caruthersville, Missouri, Exhibit 14-N (R. 101-103); and Contract with citizens of the city of Charleston, Missouri, Exhibit 15-O (R. 105-107).

[4] Contract with C. L. Lee, acting for citizens of Charleston, Illinois, Exhibit 2-B (R. 39); Contract with the Mattoon Association of Commerce of Mattoon, Illinois, Exhibit 3-C (R. 41-47); Contract with Salem Chamber of Commerce, Salem, Illinois, Exhibit 7-G (R. 69); Contract with Chamber of Commerce, Litchfield, Illinois, Exhibit 8-H (R. 71-73); Contract with citizens of Pittsfield, Illinois, Exhibit 13-M (R. 99); and Contract with Murphysboro, Illinois, Chamber of Commerce, Exhibit 16-P (R. 108-109).

[5] In this respect the situation is different from that involved in *Frank Holton & Co.*, 10 B.T.A. 1317, decided under the earlier excess profits tax law and relied upon by the Tax Court in the instant case, because in that case title to the property had not passed to the taxpayer and was to be transferred to it only after it had met certain obliga-

instances the contracts contained a clause to the effect that the contributed money was "to be used"[6], and three other contracts contained a clause to the effect that the contributed money was to be "available,"[7] for the payment of a factory building.

The stipulated period provided for in eleven of the contracts,[8] during which the petitioner was to operate the plant, had expired in all but four contracts involving property and cash totaling $190,471.56. (R. 28, 29).

---

tions. Such transfer had not taken place on the date which was determinative for the computation of invested capital.

The situation of the petitioner in the instant case is also different from that involved in *C. L. Downey Co.* v. *Commissioner*, 172 F. (2d) 810, relied upon by the Court of Appeals. There, a Chamber of Commerce had advanced money to the company for which the company executed its note with the understanding that the company would be relieved of the necessity of repayment if it complied with certain stipulated obligations concerning the operation of the factory. These obligations had not been met at the critical date. The company contended for the inclusion of the amount in invested capital as "borrowed capital" under Sections 717 and 719 of the Internal Revenue Code, and not as part of its equity invested capital under Section 718, I.R.C.

[6] These five contracts are the contracts with the Charleston Merchants Association, Exhibit 1-A (R. 35); with the Chamber of Commerce of Union City, Exhibit 5-E (R. 57); with the Vincennes Chamber of Commerce, Exhibit 9-I (R. 75); with the Pittsfield Development Association, Exhibit 12-L (R. 95); and with the Charleston Commercial Club, Charleston Junior Chamber of Commerce, Charleston Kiwanis Club and the mayor of the city of Charleston, Exhibit 15-O (R. 105).

[7] These three contracts are the contracts with the Mattoon Association of Commerce and citizens of Mattoon, Exhibit 4-D (R. 51); with the Salem Chamber of Commerce and citizens of Salem, Exhibit 6-F (R. 65); and with the Sullivan Community Club, Exhibit 11-K (R. 87). On the other hand, the contract with the Moberly Industrial Foundation, Exhibit 10-J (R. 79) provides that in consideration of a money contribution of $75,000 the petitioner was to build and operate an addition to its factory, such addition "to be constructed at the expense of said company."

[8] Namely, in the ten contracts identified in footnote 3 on page 4, *infra*, and in the contract with the Murphysboro Chamber of Commerce, Exhibit 16-P (R. 108-9), which contract does not provide for a duty to repay or reconvey.

The petitioner, after it had complied with all of the terms of the respective contracts and the specified period (in those contracts which so provided) had expired, was free to operate the factories in any way it desired, or to dispose of them and retain the proceeds without any obligation to account to the contributing groups (R. 28-30, Exhibits 1-A to 16-P, R. 35-109). The Tax Court assumed, and was correct in so doing, that the petitioner had fulfilled all conditions attached to the transfers (R. 24).

When received from the community groups, the cash was deposited in petitioner's general bank account out of which it paid its general operating expenses, the cost of acquiring other assets and the cost of constructing or acquiring the buildings, machinery and equipment for the factories in the particular communities. The cash received from a particular group "was not earmarked for or held intact and applied against the cost of factory, machinery, equipment, or other items applicable to the plant acquired or constructed in the particular community" (R. 31). The cash payments when received from the community groups were credited to its earned surplus accounts, either directly or after they had first been credited to contributed surplus (R. 30, 31, 113, 114).

The values (stipulated basis) of the two buildings received from the community groups and used in petitioner's trade or business, during the taxable years here involved, were set up in the building account on the asset side of its balance sheet and were credited directly to the surplus account on the liability side (R. 30, 31, 114). The parties have stipulated that the two buildings received by petitioner directly from two of the community groups had "bases" under Section 113(b) of the Internal Revenue Code, for the purpose of computing depreciation and for inclusion in invested capital, in the amounts of $20,251.93 and $65,219.63, respectively (R. 32).

The petitioner found it necessary to train new employees for employment in the new or enlarged factories in the communities from which it received the contributions. The cost of training such new employees was not less than $100 for each new employee. Before the new or enlarged factories could be operated, the petitioner had to supply them with an opening inventory of the materials necessary for the manufacture of shoes. The parties have stipulated the cost of training the new employees, the cost of the opening inventory, the cost of the buildings, cost of machinery, and the cost of land (in instances where land was purchased) for each of the new or enlarged factories in the communities from which it received the contributions (R. 32, 33, 119).

In every instance the cash which the petitioner received from the community groups was less than the amount which it expended for the construction or acquisition of the factory buildings and for machinery and equipment with which to operate the said factories (R. 31). At all times material to the issues in this case, the petitioner had "accumulated earnings and profits" in excess of $971,031.01 (R. 129).

In computing its excess profits net income for the two taxable years here involved, the petitioner deducted depreciation on the two buildings received directly from the community groups and also deducted depreciation on the full cost of the factory buildings, machinery and equipment acquired or enlarged in the communities from which it had received cash contributions. The Commissioner of Internal Revenue disallowed the deduction for depreciation on the two buildings, which the petitioner had received directly from the community groups, and he also disallowed an amount which he determined to be depreciation on the portion of the building, machinery and equipment

which might have been acquired with cash received from the community groups. (R. 13, 16).

The petitioner included the amount of $971,031.01 in its equity invested capital for the two years here involved, but the Commissioner reduced petitioner's equity invested capital by that amount (R. 31-32).

The Tax Court sustained the Commissioner's determination in reducing petitioner's equity invested capital by the amount of $971,031.01 on the ground that the said sum did not constitute part of petitioner's "accumulated earnings or profits", nor part of its invested capital because "the transferors were not stockholders" (R. 24, 25).

The Tax Court also sustained the Commissioner of Internal Revenue in disallowing the deduction of depreciation on the two buildings received directly from the community groups on the ground that "the recipient does not receive a gift and therefore does not take the transferor's basis under section 113(a)(2) on buildings transferred to it as an inducement to locate its business in a particular place." (R. 25) However, the Tax Court held that the Commissioner was not justified in disallowing the deduction for depreciation on a portion of the cost of the buildings, machinery and equipment constructed or acquired by the petitioner in the communities from which it had received cash contributions because "the petitioner paid for the buildings and machinery out of its own unrestricted funds, those buildings and that machinery had cost to it, as shown on its books and records, and it is entitled to depreciation thereon." (R. 26)

On appeal by both parties, the Court of Appeals reversed the Tax Court's finding that the buildings and machinery, constructed or acquired by the petitioner in the communities from which it had received cash contributions, had "cost" to the petitioner in the amounts which it had ex-

pended therefor, and held that the Tax Court's finding was "clearly erroneous" within the meaning of Rule 52(a) of the Federal Rules of Civil Procedure because petitioner's basis for depreciation of the factory buildings and equipment in question is cost and because "cost" means "cost to the taxpayer" and "cost to the taxpayer does not include contributions from others made for business and community interests." (R. 153-154)

The Court of Appeals sustained the Tax Court's determination that petitioner was not entitled to deduct depreciation on the two buildings received directly from two of the community groups, on the ground that under the Statute, 26 U.S.C.A. Section 114, depreciation is allowable "only on the cost to the taxpayer of the property" (R. 160).

The Court of Appeals sustained the Tax Court's determination that petitioner was not entitled to include the amount of $971,031.01 in its equity invested capital as a "contribution to capital" within the meaning of Section 718(a)(1) and (2) of the Internal Revenue Code, because the contributions were not made by shareholders, stating "until the Supreme Court has construed the 1940 Act otherwise, we cannot say that the decision of the Tax Court in this regard is clearly erroneous" (R. 160), and it held that the amount of $971,031.01 was not includable in petitioner's equity invested capital as part of petitioner's "accumulated earnings and profits," because petitioner "did not include any part of that amount in its income tax returns and pay income taxes thereon" (R. 158).

Specification of Errors To Be Urged

The Court below erred:

1. In holding that the amount of $971,031.01, representing cash and property previously received by the peti-

tioner from the community groups, is not includable in petitioner's equity invested capital as money and property paid in as a "contribution to capital" within the meaning of Section 718(a)(1) and (2), I.R.C.

2. In holding that the said amount of $971,031.01 is not includable in petitioner's equity invested capital as part of its "accumulated earnings and profits" within the meaning of Section 718(a)(4), I.R.C.

3. In holding that the petitioner was not entitled to a deduction for depreciation on the two buildings which it had received directly from two community groups.

4. In setting aside as "clearly erroneous" the findings of the Tax Court to the effect that the petitioner had a "cost" basis for depreciation equivalent to the total cost of the buildings constructed by it and machinery and equipment acquired by it in the communities from which it had received cash contributions in the aggregate amount of $885,559.45.

5. In holding that the petitioner's "basis" for depreciation of the buildings constructed by it and the machinery and equipment acquired by it for use in the factories in the communities from which it had received cash contributions, must be reduced by the amount of the cash contributions, as determined by the Commissioner of Internal Revenue.

6. In failing to pass upon petitioner's alternative contention that if the cash contributions received from the various communities are to be treated, for tax purposes, as a payment of a portion of petitioner's cost of starting the factory in the particular community, then the contribution should be allocated not only to the cost of land, buildings, machinery and equipment, but also to the cost of

training new employees and the cost of providing opening inventories with which to operate the factories.

7. In entering judgment for the Commissioner in the two appeals before the Court.

Summary of Argument

I. *The Invested Capital Issues*

The decisions, relied upon by the courts below, under the World War I excess profits tax[9] holding that contributions from nonshareholders are not includable in invested capital, are not in point here because of the different statutory definition of invested capital under the World War II excess profits tax. Invested capital under the earlier law was limited to money or property paid in by shareholders for stock or as paid-in surplus, and earnings accumulated by the taxpayer from past operations.

Under the World War II excess profits tax, the definition of invested capital was broadened to include not only money and property (1) paid in by the shareholders for stock or as paid-in surplus, and (2) earnings accumulated from past operations, but also (3) contributions to capital and (4) borrowed capital which had been explicitly excluded under the earlier law.

The Commissioner's regulations, promulgated under the income tax law (chapter 1 of the Internal Revenue Code), in effect at the time that "a contribution to capital" was adopted as a component of equity invested capital, explicitly provided that "a contribution to capital" may be re-

[9] For convenience, the earlier excess profits tax law (Title II, Revenue Act of 1917, 40 Stat. 300; Title III, Revenue Act of 1918, 40 Stat. 1057; Title III, Revenue Act of 1921, 42 Stat. 227) will be referred to herein as the World War I excess profits tax. The later excess profits tax law (Subchapter E of the Internal Revenue Code) will be referred to as the World War II excess profits tax.

ceived "*from any person.*" The regulations, subsequently promulgated under the invested capital section of the excess profits tax provisions of the Internal Revenue Code (subchapter E) also provided that a contribution to capital may be received "*from any person.*" The Commissioner's insistence in this case that the contributions of money and property in the amount of $971,031.01 are not includable in petitioner's equity invested capital because they were received from nonstockholders, and the lower courts' approval of that argument constitutes, in effect, a repudiation of the Commissioner's regulations on this point.

Contributions of the nature of those here involved have been characterized by this Court, by other courts and by authors of legal, financial and accounting texts as "contributions to capital." Common usage of the term, when Congress first adopted it as part of the income tax law in the Revenue Act of 1932, included contributions of the nature of those here involved.

If this Court should determine that the contributions of money and property other than money in the aggregate amount of $971,031.01 are not includable in petitioner's invested capital as "a contribution to capital," then, as petitioner contends in the alternative, the amount is includable in invested capital as part of its "accumulated earnings and profits" as of the beginning of each of the two taxable years here involved.

The contributions of $971,031.01, being received by petitioner without a corresponding liability, increased the excess of its assets over its liabilities, including capital stock, by a like amount thereby increasing petitioner's surplus as defined by this Court.[10] That surplus was available for distribution to petitioner's stockholders and if distributed

---

[10] Petitioner had at all times material to this case accumulated earnings and profits in excess of $971,031.01 (R. 129).

would be taxable to the stockholders as a distribution of "earnings or profits" within the meaning of Section 115 of the Internal Revenue Code.

Since the term "accumulated earnings and profits" as used for excess profits tax purposes is given the same meaning as when used for income tax purposes, it follows that the surplus created by the receipt of the contributions here in question constitutes part of petitioner's "accumulated earnings and profits" as of the beginning of each of the two taxable years here involved and is includable in petitioner's invested capital.

The inclusion of the contributions of $971,031.01 in petitioner's invested capital is consistent with the general scheme of the World War II excess profits tax, which was designed to tax at high rates the excessive earnings of corporations resulting from the rearmament program and the war expenditures. The contributions here involved were received prior to and have no connection with either the rearmament program or the war. They were actively employed as part of petitioner's "working capital" during the years now before this Court, and to exclude them from its invested capital would result in taxing as excessive profits, earnings which are in fact merely a normal return upon petitioner's "working capital."

II. *The Depreciation Issues*

The court below erred in determining that petitioner's basis for depreciation, as otherwise determined, should be reduced by the contributions of cash and property other than cash in the aggregate amount of $971,031.01 on the ground that petitioner is restricted to a "cost" basis for depreciation. Since the amount of $971,031.01 represents "a contribution to capital," petitioner is entitled to the transferor's basis for computing depreciation as provided by Section 113(a)(8)(B) of the Internal Revenue Code.

If this Court should conclude that the contributions in question represent gifts but not a contribution to capital, petitioner would still be entitled to the donor's basis under Section 113(a)(2) of the Internal Revenue Code.

The court below also erred in setting aside as "clearly erroneous" the finding of the Tax Court that the buildings, machinery and equipment in petitioner's factories, located in the communities from which petitioner had received cash contributions, had "cost" to petitioner of the amounts on which petitioner had claimed depreciation. Such finding was fully supported by the record.

The court below also erred in failing to consider petitioner's alternative contention that if the cash contributions were to be used to reduce petitioner's "basis" for depreciation, then such cash contributions should be allocated in part to the cost of training new employees to operate the new or enlarged plants and in part to the cost of providing opening inventories.

ARGUMENT

I. *The Invested Capital Issues.*

(1) The contributions to petitioner in cash and property other than cash in the aggregate amount of $971,031.01 represent "contributions to capital" and are includable in petitioner's equity invested capital under the provisions of Section 718(a)(1) and (2) of the Internal Revenue Code

The uncontradicted facts are that petitioner received from the citizens of various communities during the years 1914 to 1939, inclusive, cash in the amount of $885,559.45 and title to two buildings having a stipulated basis under Section 113(b) of the Internal Revenue Code of $85,471.56, the total amounting to $971,031.01 (R. 24, 28-29). The cash had been paid over to petitioner and the title to the two buildings had been transferred to petitioner prior to

the beginning of the first taxable year here involved (R. 28, 29).

In one instance a payment of $10,000.00 had been made to petitioner without a contract, such payment being designated as a part of its "organization expenses in starting the factory" (R. 28). In all other instances, there were contracts between petitioner and the contributing groups, which varied widely in their terms, but in every instance the contribution was made as an inducement to petitioner to acquire and operate a new factory, or to enlarge and operate an existing factory, in the particular community.

There was no other relationship between petitioner and any of the contributing parties (or the individuals constituting the community groups) except the general relationship created by the contracts; namely, that of a contributor for the welfare of the community on one hand, and an obligation to acquire or enlarge a plant and to operate it in good faith on the other hand. None of the contributors acquired any interest in the plant, any right to employment in the plant, any right to purchase the product manufactured in the plant, or any other right except to see that the plant was operated in the community for the period of time and under the conditions specified in the contract. This fact distinguishes the instant case from the situation in *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, 103, where this Court held that a payment made by a customer of a utility company toward the cost of constructing a line to his home or place of business represented "to the customer the price of the service". There, the customer had an enforcible right to the continued service by the utility company after the line had been completed. Here, the contributor acquired no right in the new or enlarged plant, or to its products, except to see that it was operated pursuant to the terms of the contract

for the period of time specified in the contract.[11] After that period had expired, the petitioner was free to operate the plant or to dispose of it and use the proceeds in any way that it might choose (R. 28-30, 35-109).

The plants acquired by petitioner in the communities from which the contributions had been received were being operated by petitioner during the years here involved, although the period during which petitioner was obligated to operate them under certain of the contracts, had expired in all except four instances.[12]

The aggregate amount of $971,031,01, representing the cash and property other than cash received from the communities in question, was reflected in petitioner's surplus account at the beginning of the first taxable year here involved, and was included by petitioner in its equity invested capital for both taxable years (R. 30, 31, 113, 114). The Commissioner reduced petitioner's equity invested capital by that amount.

In computing its excess profits tax for the taxable years here involved, the petitioner used the excess profits credit based on invested capital, because such method produced the lesser amount of tax (Section 712, I.R.C.; Appendix, *infra*, p. 72).

The Tax Court held that the amount of $971,031.01 did not constitute part of petitioner's equity invested capital because "the transferors were not stockholders" (R. 25). This action was upheld by the Court of Appeals on the ground that "until the Supreme Court has construed the 1940 Act otherwise we cannot say that the decision of the Tax Court in this regard is clearly erroneous" (R. 160).

---

[11] Four of the contracts did not even specify any required period of operation (p. 3, footnote 2, *supra*).

[12] (R. 95-97; 101-103; 105; 108-109).

(a) The decisions under the World War I excess profits tax relied upon by the courts below are not applicable to this case arising under the World War II excess profits tax because the two acts define "invested capital" different

In reaching the decision that the contributions of cash and property in the aggregate amount of $971,031.01 are not includable in petitioner's equity invested capital as "a contribution to capital" because the contributors were not shareholders, the Tax Court (by following its decision in *McKay Products Corporation*, 9 T. C. 1082) and the Court of Appeals relied upon the decision of this Court in *La Belle Iron Works* v. *United States*, 256 U. S. 377. The Tax Court also cited its own decision in *Liberty Mirror Works*, 3 T.C. 1018, and the decision of the Board of Tax Appeals in *Frank Holton & Co.*, 10 B.T.A. 1317 (R. 24-25, 157, 158).

The decision of this Court in the *La Belle Iron Works* v. *United States*, *supra*, and the decision of the Board of Tax Appeals in *Frank Holton & Co.*, *supra*, were rendered under the World War I excess profits tax. *Liberty Mirror Works*, *supra*, was decided under the World War II excess profits tax, but the conclusion of the Tax Court that a contribution from a nonstockholder is not includable in invested capital was based upon the decision of this Court in *La Belle Iron Works* v. *United States*, *supra*, and the decision in *Frank Holton & Co.*, *supra*.

The above decisions construing the invested capital provisions of the earlier excess profits tax are not applicable to the World War II excess profits tax because of the different composition of invested capital under the two laws. In the earlier law, invested capital was limited to

capital originating with the shareholders; plus earnings accumulated from past operations, while invested capital under the World War II Excess Profits Tax was broadened to include not only capital originating with the shareholders and earnings accumulated from past operations, but also (1) contributions to capital and (2) borrowed capital.

Thus, Section 326 of the Revenue Acts of 1918 and 1921 [13] defines the term "invested capital" to mean:

> "(1) Actual cash bona fide paid in for *stock or shares;*
>
> "(2) Actual cash value of tangible property, other than cash, bona fide paid in for *stock or shares* . . .
>
> "(3) Paid-in or earned surplus and undivided profits . . .
>
> "(4) Intangible property bona fide paid in for *stock or shares* prior to March 3, 1917 . . .
>
> "(5) Intangible property bona fide paid in for *stock or shares* on or after March 3, 1917 . . ." (Emphasis supplied.)

Section 207(a) of the Revenue Act of 1917 (40 Stat. 300) contained substantially the same provisions but the language varied somewhat, because that Act also subjected partnerships to excess profits tax, while the 1918 and 1921 Revenue Acts levied the tax only on corporations.

Borrowed capital was explicitly excluded as a component of invested capital under the earlier law.[14]

It is clear that the earlier law limited invested capital to capital originating with the stockholders with the exception of "earned surplus and undivided profits" which originate with the taxpayer itself. In line with common usage, "paid-in surplus" was defined to mean surplus paid in

[13] 40 Stat. 1057, and 42 Stat. 227, respectively.

[14] Section 207 of the Revenue Act of 1917, 40 Stat. 300; Section 326(b), Revenue Acts of 1918 and 1921, 40 Stat. 1057 and 42 Stat. 227, respectively.

"by a stockholder" and that definition has continued unchanged to the present time.[15]

Therefore, in construing Section 207 of the Revenue Act of 1917 in *La Belle Iron Works* v. *United States, supra,* this Court stated (pages 388-389):

> "Cash paid in, and tangible property paid in other than cash, are confined to such as were contributed *for stock or shares* in the corporation or partnership; and the property is to be taken at its actual cash value 'at the time of such payment,'—distinctly negativing any allowance for appreciation in value . . . .
>
> "The *same controlling thought* is carried into the proviso, which relates to the valuation of patents, copyrights, trademarks, good will, franchises, and similar intangible property. *Every line shows evidence of a legislative purpose to confine the account to such items as were paid in for stock or shares,* and to their values 'at the time of such payment;' * * * *" (Emphasis supplied.)

In *Frank Holton & Company, supra,* also relied upon by the Tax Court, the Board of Tax Appeals held that the taxpayer could not include, in its invested capital for the years 1919 and 1920, the value of a factory building which a community group had promised to transfer to the taxpayer after it had met a specified payroll and had complied with other contractual conditions. The Board based its decision on the ground that the contributors were not stockholders, relying upon the decision of this Court in *La Belle Iron Works* v. *United States, supra.*

When the recent excess profits tax was imposed by the Second Revenue Act of 1940, the principle of limiting invested capital to capital originating with the shareholders,

[15] Article 837 of Regulations 45 (1920 ed.); Regulations 62 (1922 ed.); Treasury Regulations 111, Section 29.113(a)(8)-1 and Treasury Regulations 112, Section 35.718-1, Appendix, *infra*, pp. 76, 78.

plus earnings accumulated from past operation, was abandoned. The definition of invested capital under the new law was broadened to include, not only the capital originating with the shareholders and capital originating with the taxpayer itself from past earnings, but also (1) contributions to capital and (2) borrowed capital, both of which were foreign to the earlier law.

Section 717 of the Internal Revenue Code which, so far as here material, remained unchanged until the excess profits tax was repealed in 1945, defined invested capital as follows:

> "The daily invested capital for any day of the taxable year shall be the sum of the equity invested capital for such day plus the borrowed invested capital for such day determined under section 719."

Equity invested capital was defined to include among other items the following (Section 718, I.R.C.):

> "(a) DEFINITION.—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—
>
> (1) MONEY PAID IN.—Money previously paid in for stock, or as paid-in surplus, *or as a contribution to capital;*
>
> (2) PROPERTY PAID IN.—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, *or as a contribution to capital.*" (Emphasis supplied.)

The inclusion of (1) borrowed capital and (2) a contribution to capital in the definition of invested capital under the later Act clearly negatives any "legislative purpose to confine" invested capital "to such items as were paid in for stock and shares", as this Court found to be true with

respect to the earlier law. *La Belle Iron Works* v. *United States*, *supra*.

Both laws sought to recapture a substantial portion of the excessive earnings which were realized as a result of the tremendous expenditures incidental to the two World Wars by taxing, at the high excess profits tax rates, the excess over what was regarded as "normal earnings" of the taxpayer. However, the basic concept of "normal earnings", was different under the two acts.

Under the earlier Act, "normal earnings" were measured by a fair return *on the shareholders' investment in the corporation* and earnings accumulated from past operations.

Under the later Act, "normal earnings" were measured by a fair return on the *working capital of the corporation*. The corporation was given the choice of two methods for determining such fair return; namely, (1) its average earnings during the base period years, 1936 to 1939, inclusive (Section 713, I.R.C.), or (2) a specified return on its invested capital, which, as previously pointed out, included not only capital paid in by the shareholders and accumulated earnings, but also contributions to capital and borrowed capital (Section 714, I.R.C.; Appendix, p. 72 *infra*).

The concept of "normal earnings" under the World War II excess profits tax has been described by this Court as follows (Footnotes omitted.):

> "Under the controlling 1943 law the amount of income subject to this excess profits tax is computed by subtracting from the net income subject to regular income tax the amount of earnings Congress deemed to be a taxpayer's normal and fair return. This deductible amount, called the excess profits credit, was to be computed in one of two ways, whichever resulted in the lesser tax. Sec. 712. The first, not used here, permits a deduction of an amount equal to the com-

pany's average net income for the taxable years 1936 to 1939 inclusive. Sec. 713. The second used here, permits a deduction of an amount equal to 8 per centum of the taxpayer's invested capital for the taxable year. Sec. 714. An includable element of the 'invested capital' is the 'accumulated earnings and profits as of the beginning of such taxable year.' It thus appears that by this method Congress intended, with minor exceptions not here relevant, to impose the excess profits tax on all annual net income in excess of 8% of a corporation's *working capital*, including its accumulated profits." *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 497 (Emphasis supplied.)

Therefore, it is apparent that the decision of this Court in *La Belle Iron Works* v. *Commissioner*, *supra*, and the decision of the Board of Tax Appeals in *Frank Holton & Co.*, *supra*, while correct under the earlier law, are not applicable to the computation of invested capital under the World War II excess profits tax because of the different concept of normal earnings and the different composition of invested capital under the later act. Consequently, the decision of the Tax Court and the decision of the Court of Appeals in this case are incorrect because both are premised upon the decisions under the earlier act and fail to take into consideration the different statutory composition of invested capital under the later act.

(b) The Commissioner's Regulations in effect at the time of the adoption of, and those promulgated by him under, the World War II excess profits tax recognize that a "contribution to capital" may be received from "any person"

The legislative history of the invested capital provisions of the World War II excess profits tax fails to throw any light on the term "contribution to capital" as used in Section 718(a)(1) and (2) of the Internal Revenue Code.

However, Section 728 of the Internal Revenue Code provided that the terms used in that subchapter (Subchapter E) "shall have the same meaning as when used in chapter 1."

Therefore, it is significant that at the time Section 718, I.R.C., was first adopted as part of the Second Revenue Act of 1940, the term "contribution to capital" was in use as part of Section 113(a)(8) of the Internal Revenue Code (a part of chapter 1 of the Code) and had been used in corresponding sections of the prior Revenue Acts continuously since the Revenue Act of 1932 as follows: [16]

"Sec. 113. Adjusted basis for determining gain or loss.

(a) **Basis (Unadjusted) of Property.**—The basis of property shall be the cost of such property; except that—

* * * * * * *

(8) **Property acquired by issuance of stock or as paid-in surplus.**—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus, *or as a contribution to capital*,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law

[16] The legislative history of this provision is discussed herein at, *infra*, pp. 57 to 59.

applicable to the year in which the transfer was made." (Emphasis supplied.)

The term "contribution to capital" was first defined in Income Tax Regulations 86 (Article 113(a)(8)-1), promulgated under Revenue Act of 1934 as follows:

> "In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, *or from any person as a contribution to capital*, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift, the basis thereof shall be determined under section 113 (a)(2)." (Emphasis supplied.)

The above provision has been included in all of the subsequent income tax regulations, including the present Regulations 111, as an interpretation of Section 113(a)(8) of the law.[17]

The reenactment of Section 113(a)(8) in the Revenue Acts of 1936 and 1938 and in the Internal Revenue Code, after the term had been defined by Regulations 86, indicates congressional approval of the Commissioner's definition of the term. On well established principles, the regulation is valid. *Brewster* v *Gage*, 280 U.S. 327, 337; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 378, and it also has the support of the doctrine that reenactment of the statute without disapproval of regulations there-

---

[17] Regulations 94 (Article 113(a)(8)-1), promulgated under the Revenue Act of 1936; Regulations 101 (Article 113(a)(8)-1), promulgated under the Revenue Act of 1938; Regulations 103 (Sec. 19.113(a)(8)-1) and Regulations 111 (Sec. 29.113(a)(8)-1), promulgated under the Internal Revenue Code, the latter Regulations being applicable to all taxable years beginning after December 31, 1941.

under gives them added sanction. *Commissioner* v. *Wheeler*, 324 U.S. 542, 547 (footnote 10).

When the Commissioner promulgated regulations under Section 718 of the Internal Revenue Code, he defined the term "contribution to capital" in the same way in which it had been defined in the regulations promulgated under chapter 1 of the Code. Thus the applicable excess profits tax regulations provide:[18]

> "If the property was acquired after December 31, 1920, by a corporation from a shareholder as a paid-in surplus *or from any person as a contribution to capital*, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made." (Emphasis supplied.)

The Commissioner's Regulations have long provided that paid-in surplus originates with the stockholders.[19] The term "contribution to capital" must, therefore, imply something else or something of a broader meaning so as to include contributions to capital made by stockholders and nonstockholders. This was the view of the Treasury Department at the time that it promulgated its Regulations under Section 718, I.R.C., because, as indicated above, it provided that a contribution to capital may be received from "any person." The term "any person" is plain and not open to doubt, and it is impossible to read into that term such a limitation as to restrict the contributor to stockholders[20] or, as the Commissioner contended be-

[18] Regulations 109, Section 30.718-1; Regulations 112, Section 35.718-1. Appendix, *infra*, p. 78.

[19] Article 837, Regulations 45 (1920 ed.) and Regulations 62 (1922 ed.). Treasury Regulations 111 and 112, which are now in force, so provide in Section 29.113(a)(8)-1 and Section 35.718-1, respectively. (Appendix, *infra*, pp. 76, 78).

[20] Section 3797(a)(1), I.R.C., provides: "When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof— • • • the term 'person' shall be construed to mean and include an individual, a trust, estate, partnership, company or

fore the Court of Appeals in *Commissioner* v. *McKay Products Corporation*, 178 F. 2d 639, 641, "bondholders or holders of some hybrid security."

The provision in the excess profits tax regulations that a "contribution to capital" may be made by "any person" is consistent with the Statute and is a contemporaneous interpretation by the Treasury Department of the excess profits tax provisions and also of the income tax provisions, which must be regarded as having found congressional approval. These regulations are therefore binding, not only on the taxpayers and the Commissioner, but also on the courts and should not be overruled unless for weighty reasons. By holding that contributions to capital can be made only by stockholders, the Tax Court and the Court below have, in effect, invalidated the Treasury regulations and have failed to give any persuasive reasons therefor.

(c) The courts and authors of legal and accounting texts regard contributions of the nature of those here involved as "contributions to capital"

That the amount of $971,031.01 constitutes and was intended to constitute a contribution to petitioner's capital, as distinguished from contributions to its current earnings, seems clear beyond doubt.[21] The money and property when received by the petitioner were set up on the

---

corporation." Subparagraph (2) of the same section provides: "The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on * * *". It is therefore clear that the contributing community groups or the individuals constituting them are 'persons' within the meaning of the Internal Revenue Code.

[21] If the amount were held to be a contribution to current earnings, it would still be includable in petitioner's equity invested capital under Section 718(a)(4) of the Internal Revenue Code as part of petitioner's accumulated earnings and profits. This point is discussed, *infra*, pp. 36 to 55.

asset side of its balance sheet in the cash account and property account, respectively. There being no corresponding liability incurred by the petitioner in connection with the receipt of the money and property, they obviously increased the excess of its assets over its liabilities, thereby increasing petitioner's capital.

In *Edwards* v. *Cuba Railroad Co.*, 268 U. S. 628, 632 (1925), this Court held that certain money and property received by the taxpayer from the Government of Cuba for the construction of a railroad did not constitute taxable income, but represented a contribution to the taxpayer's capital assets, stating (p. 632):

> "The subsidy payments were proportionate to mileage completed; and this indicates a purpose to reimburse plaintiff for capital expenditures • • • All —the physical properties and the money subsidies— were given for the same purposes. It cannot reasonably be held that one was contribution to capital assets, and that the other was profit, gain or income."

The fact that the contributions in the instant case were received from private sources does not distinguish them from the subsidy payments involved in *Edwards* v. *Cuba Railroad Company, supra.*[22] In identifying the character of the payments involved in that case, this Court made no distinction between those received from public sources and those received from private sources, as indicated by the following excerpt from its opinion (p. 632):

> "• • • Such aids, gifts and grants from the government, subordinate political subdivisions, *or private*

[22] This has also been the position of the Treasury Department, whose General Counsel ruled that contributions made by local community groups or chambers of commerce to manufacturing concerns for the purpose of inducing them to locate their plants in the particular community do not result in taxable income, basing this conclusion on *Edwards* v. *Cuba Railroad Co.*, G.C.M. 16952 (Cum. Bull. 1937, 1, p. 134). Appendix, *infra*, pp. 79 to 82.

> *sources*,—whether of land, other property, credit, or money,—in order to induce construction and operation of railroads for the service of the public, are not given as mere gratuities. (citing cases) * * * Usually they are given to promote settlement and to provide for the development of the resources in the territory to be served. The things so sought to be attained in the public interest are numerous and varied. * * *" (Emphasis supplied.)

In *Texas & Pacific Railway Co.* v. *United States*, 286 U.S. 285 (1932), the railroad there involved had received payments from the Government under the Transportation Act of 1920, which provided that all railroads which had been operated by the Government during the war were guaranteed operating revenues for the six months following March 1, 1920, of not less than half the compensation agreed upon in their contracts with the Government during the period of Federal control. This Court held that the payments received pursuant to the guarantee constituted taxable income and contrasted them with contributions to capital of the nature involved in *Edwards* v. *Cuba Railroad Co.*, *supra*, stating (p. 289):

> "The sums received under the Act [Transportation Act of 1920] were not subsidies or gifts,—that is, *contributions to the capital of the railroads,—and this fact distinguishes cases such as Edwards* v. *Cuba Railroad Co.*, 268 U. S. 628. * * * where the payments were conditioned upon construction work performed * * *." (Emphasis supplied.)

These decisions were available to Congress at the time that it first used the term "contribution to capital" in Section 113(a)(8) of the Revenue Act of 1932. Undoubtedly, the term was used in that section in the same sense in which this Court used it in the above-quoted decisions. There can be no doubt that these two decisions were also

well known to the Treasury Department when it issued both its regulations under Section 113(a)(8) of the Revenue Act of 1934 and succeeding revenue acts and the Code (see page 24, *supra*), and also its regulations under Section 718(a)(1) and (2) (see page 25, *supra*).

In *Helvering* v. *Claiborne-Annapolis Ferry Co.*, 93 F. 2d 875 (C.C.A. 4th, 1938), the taxpayer, who operated a ferry across the Chesapeake Bay, received from the State of Maryland annually an amount of $23,000 toward the operation of the ferry. It had other income from the operation of the ferry. One of the questions before the court was whether the amount of $23,000 was income or a contribution to capital. The court held that the amount received by the company from the State of Maryland was clearly income and not a contribution to capital, stating (at p. 876):

> "And it is equally clear that the amount paid by the State was not intended by anyone as a contribution towards or an addition to the capital investment of the taxpayer. Taxpayer's capital was invested in wharves and ferryboats; and the payment by the state was intended, *not to reimburse taxpayer for expenditures it had made in their purchase of equipment*, but to compensate it in part for their operation. As stated above, it was treated in all respects like other income and was available for operating expenses or for the payment of dividends. The case of Edwards v. Cuba Railroad Co., * * * upon which taxpayer chiefly relies, is readily distinguishable. In that case the subsidy payments made by the Cuba government were used to reimburse taxpayer for capital expenditures." (Emphasis supplied.)

In *Lykes Bros. Steamship Co., Inc.*, 42 B.T.A. 1395 (1940), *aff'd.* 126 F. 2d 725 (C.C.A. 5th), the taxpayer contended that certain mail payments received from the Postmaster General for the transportation of ocean mail were exempt to the extent of $250,000, which it was required to hold for

certain special purposes. The Board of Tax Appeals (now the Tax Court of the United States) rejected the taxpayer's contention, stating (at p. 1401):

> "There is little room for doubt that *the entire sums* paid to the petitioner in the taxable years *were subsidies in the sense* that they were governmental aids or grants designed to encourage the expansion of the American Merchant Marine. The huge sums paid in excess of normal postal rates were clearly for that purpose. But, applying the broad term of subsidy to the amounts paid to the petitioner does not solve the question in issue here, because of *the different purposes* for which such governmental grants are made. From the Supreme Court cases a few general rules may be drawn. Governmental grants made in order *to induce construction and operation of railroads are not mere gifts.* Burke v. Southern Pacific R. R. Co., 234 U. S. 669, 679. Such a grant made to a railroad company proportionate to mileage of railway completed is treated as a *reimbursement for capital expenditures and is not income.* Edwards v. Cuba Railroad Co., supra." (Emphasis supplied.)

On appeal, the Court of Appeals for the Fifth Circuit, 126 F. 2d 725, 727, remarked that no part of the payments

> "can be identified as a contribution to capital under *Edwards* v. *Cuba Railroad Co., supra.*"

Authors, who have discussed the nature of contributions similar to those involved in the instant case, have reached the conclusion that they constitute "contributions to capital." Magill, *Taxable Income*, Revised Edition 1945, pp. 387 to 392, discusses the nature of the payments involved in *Edwards* v. *Cuba Railroad Co., supra*, and states (p. 387, 389)

> "Since the subsidy did not come from the stockholders of the railroad * * * *it is a contribution to capital.* There was a net increase in its actual assets which,

it seems, was properly credited to surplus and was available for dividends * * *.

* * * * * * * * *

"They are *all contributions to capital whether* by the Government, by stockholders, or *by third parties*, ouside the bounds of taxable income * * *." (Emphasis supplied.)

He also concludes (pp. 391, 392) that contributions made by chambers of commerce and similar organizations, to induce new industries to settle in their communities constitute capital contributions analogous to those involved in *Edwards* v. *Cuba Railroad Co., supra.*

Harvey, *Some Indicia of Capital Transfers under the Federal Income Tax Laws* (1939) 37 Mich. L. Rev. 745, discusses at length the nature of contributions, such as those involved in the instant case, and expresses the opinion that they represent "contributions to capital." The same conclusion is reached by O'Meara, *Contributions to Capital by Nonshareholders* (1948) 3 Tax Law Review 568.

Authors of financial and accounting texts have reached the same conclusion. Jules I. Bogen in *Financial Handbook*, 3d Ed. (1948) states (p. 808):

"* * * Surplus arises from gifts of assets also in the case of a corporation which receives a donation of a tract of land as an inducement to locate its factory at a designated place. Such gift may be conditioned upon the erection of a factory building, the employment of a stated number of men, etc. After the conditions are fulfilled the surplus arising from the donation may be utilized as the directors dictate, even as the basis for dividend distribution."

Raymond P. Marple, in *Capital Surplus and Corporate Net Worth* (1936), states (pp. 137 and following):

"Donations by stockholders represent contributed capital and, to the extent by which they exceed legal

> capital, should be recorded in capital surplus. * * * Donations by persons who are not stockholders and do not become stockholders by the contribution do not represent investments and must be classified as contributed capital or surplus according to the intents and desires of the person making the contribution. * * * Where the gift [by outsiders] is not intended as permanent capital, but is made available for current use it should be treated as earned surplus. The above is written with a full realization of the fact that donations, even though made available for current dividend purposes, are not 'earnings' in the generally accepted sense of that term. * * * No one is hurt by the declaration of a dividend from a surplus donated for current purposes."

The theory urged by the Commissioner in the Court of Appeals that "the capital of a corporation, as that term is used in the statute, consists only of the capital as defined in its charter and paid in by the stockholders and that there can be no 'contribution to capital' unless a deficit exists therein" (R. 159) is not only at variance with the common usage of the term "contribution to capital" in the legal, financial and accounting sense but also renders the use of that term in Section 718(a)(1) and (2) completely nugatory. If there could be no "contribution to capital" unless a deficit exists in the capital originally paid in by the stockholders, then the use of the term "contribution to capital" as a component of equity invested capital would be meaningless because the corporate taxpayer is expressly given the benefit of the money or property paid in for stock regardless of the time paid in and is not required to reduce that capital by any subsequent impairment. Under certain circumstances the taxpayer is even given the benefit of a deficit in earnings and profits of another corporation, Section 718(a)(7) I.R.C.

There would be no point in defining equity invested capital as money or property paid in for stock or as paid in

surplus "or as a contribution to capital" if the "contribution to capital" were limited to the amount necessary to restore the impairment of the money or property paid in for stock. Obviously, Congress intended the term "contribution to capital" to include something more than money or property paid in for stock or as paid in surplus. The Commissioner's argument on this point was rejected by the Court of Appeals for the Third Circuit in *Commissioner v. The McKay Products Corporation, supra.*

It is clear that contributions from nonstockholders, such as those received by petitioner in the instant case, are "contributions to capital" in the legal, financial and accounting sense and were intended by Congress to be included in equity invested capital.

(d) The inclusion of the amounts here involved in petitioner's equity invested capital as contributions to capital is consistent with the general scheme of the World War II excess profits tax

The intent of Congress to permit the inclusion in equity invested capital of all money and property other than money contributed to the corporation by "any person," as provided in the regulations, seems clear when the World War II excess profits tax is considered as a whole. Two alternative methods of computing the excess profits tax credit are provided, and the petitioner is authorized to use the one which results in the lesser tax. If the petitioner had used the first alternative or average earnings method, the income produced by the contributions of $971,031.01 would have been reflected in its average base period earnings. It is hardly likely that when Congress permitted the petitioner to use the alternative invested capital method of measuring the excess profits tax credit it intended to penalize the petitioner by excluding from its invested capital the amount

of $971,031.01 actually used in the production of its taxable income.

If instead of receiving outright title to the contributions of money and property other than money in the amount of $971,031.01, petitioner had borrowed that amount of money from the contributing groups or from any other source, giving its note therefor, it would have been able to include 50% of that amount in its invested capital as borrowed capital (Section 719, I.R.C.). To exclude the amount of $971,031.01 from petitioner's invested capital because it had acquired full title to the sum from nonstockholders but to include it if petitioner had borrowed the sum from the nonstockholders is incongruous. Had Congress intended such a result, one would expect to find that intention clearly expressed in the Statute. The statutory language not only fails to indicate any such intention, but on the contrary, clearly indicates that Congress intended to include in invested capital "a contribution to capital" from "any person."

This Court concluded in *Commissioner* v. *South Texas Lumber Company, supra*, that Congress intended to include in the excess profits tax credit under the invested capital method a fair return on all of the working capital of the business stating (at p. 497):

> "* * * It thus appears that by this method Congress intended with minor exceptions not here relevant, to impose the excess profits tax on all annual net income in excess of 8% of a corporation's working capital, including its accumulated profits."

The same conclusion as that contended for by the petitioner was reached by the Court of Appeals for the Third Circuit in *Commissioner* v. *McKay Products Corporation, supra*, in which the Court held that a contribution, substantially identical with the contributions here involved,

was includable in the taxpayer's equity invested capital as a contribution to capital under Section 718(a)(1) and (2), I.R.C., stating (p. 642):

> "'Working capital' in common parlance means the value of that with which the enterprise carries on its activity. How much is its stake in the game? What is the amount of money which is in the business? When we find that, we allow that amount to be used as the basis to determine how much the business may earn before becoming subject to excess profits taxes. It seems to us unimportant who makes the contribution to this amount."

All of the contributions here involved, including the two buildings received directly from the community groups, were employed in petitioner's business during the two years here involved, and had been so employed continuously since the dates on which received. They were exposed to all of the risks of the business to the same extent as the petitioner's other capital, and to a far greater extent than borrowed capital, which would, of course, receive preferential treatment in case of insolvency or bankruptcy.

The clear language of the Statute provides that a "contribution to capital" may be included in equity invested capital. The Commissioner's own regulations, in existence at the time that Congress imposed the World War II excess profits tax, provided that a "contribution to capital" may be received from "any person" and his regulations promulgated under Section 718, I.R.C., likewise provided that a "contribution to capital" may be made by "any person." No reason appears why those regulations should be invalidated by restricting the term "any person" to stockholders or some kind of security holders. The contributions here involved are contributions to capital in the legal, financial, and accounting sense, and were intended by Congress to be included in equity invested capital. The decisions of

the Court of Appeals and the Tax Court holding to the contrary on the ground that the contributors were not stockholders are clearly erroneous and should be reversed.

(2) If the contributions in the amount of $971,031.01 are not includable in petitioner's invested capital as a "contribution to capital", then they are includable in its "accumulated earnings and profits" as of the beginning of the taxable years here involved pursuant to Section 718(a)(4), I.R.C.

Petitioner contends, in the alternative, that the contributions of cash and property other than cash in the amount of $971,031.01, which it had received from community groups long prior to the beginning of each of the two taxable years here involved, are includable in its equity invested capital as a part of its "accumulated earnings and profits" pursuant to Section 718(a)(4) of the Internal Revenue Code (Appendix, *infra*, p. 74), which reads in part as follows:[23]

> "(a) Definition.—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts reduced as provided in subsection (b)—
>
> * * * * * * *
>
> (4) Earnings and Profits at Beginning of Year.—The accumulated earnings and profits as of the beginning of such taxable year."

This provision was in effect throughout the taxable years here involved. At all times material to this case, the

---

[23] This issue was not raised in *Commissioner v. McKay Products Corporation, supra*. It is relevant here only if the Court should conclude that the amount of $971,031.01 was not a "contribution to capital". Petitioner does not contend that the amount should be included in its invested capital twice.

amount of $971,031.01 was actually reflected in petitioner's surplus account on the liability side of its balance sheet. The adjustment made by the respondent, which led to this controversy, was to reduce petitioner's "accumulated earnings and profits" by the amount of $971,031.01, thereby including only the remaining "accumulated earnings and profits" in its equity invested capital.[24]

The Court of Appeals decided this issue against petitioner on the ground that the contributions in the amount of $971,031.01 had not been included in taxable income in the years of receipt, stating (R. 158):

> "This case [*Commissioner* v. *South Texas Lumber Co.*] we think, whatever may be the proper conception of normal earnings under the 1940 Act, settles adversely to the taxpayer the contention that the amount of $971,031.01 representing the money and property received from community groups may be included in its invested capital under Section 718(a)(4) as 'accumulated earnings and profits as of the beginning of such taxable year' for the reason that it did not include any part of that amount in its income tax returns and pay income taxes thereon 'in the years of receipt'. * * *"

The decision of this Court in the *South Texas Lumber Co.* case, *supra*, did not settle the issue presented in the instant case because it involves an entirely different state of facts. The earnings and profits discussion in that case is limited to the specific problems of an installment basis taxpayer. There, the taxpayer, though keeping its books on the accrual basis, reported its income from installment sales on the installment basis under Section 44, I.R.C., under which a taxpayer is permitted to return as taxable in-

[24] At all times material to the issues in this case, petitioner's "accumulated earnings and profits" were in excess of the amount of $971,031.01 (R. 29).

come for a particular year "that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when the payment is completed bears to the total contract price". In computing its invested capital, the taxpayer included in its accumulated earnings and profits under Section 718(a)(4), contrary to the Treasury regulations,[25] the amount of "unrealized profit installment sales".

This Court upheld the validity of the regulations under which the unrealized profit installment sales were excluded from the taxpayer's accumulated earnings and profits, stating (p. 506):

> "The regulation is valid. The respondent [taxpayer] can include in its equity invested capital only that portion of its profits from installment payments which it has actually received and on which it has already paid income taxes in the years of receipt."

This Court did not hold, as the court below assumed, that in order to be includable in accumulated earnings and profits, an item must have been subjected to tax in the year of receipt. The regulations, which this Court upheld in the *South Texas Lumber Co.* case, *supra*, explicitly provided that many items which are not subject to tax when received by the corporation are, nevertheless, includable in earnings and profits.

The contributions involved in the instant case do not constitute and were not treated by respondent as taxable income to the petitioner (*G.C.M. 16952*, C.B. 1937-1, p. 133; Appendix, *infra*, pp. 79 to 82) but that does not mean that they are not includable in petitioner's "earnings and profits." The cash had been paid over and title to the two buildings had been transferred to the petitioner before the beginning of the first taxable year here involved, and

---

[25] Section 29.115-3, Regulations 111; Appendix, *infra*, pp. 77, 78.

the effect of the receipt of the cash and property other than cash had been reflected in petitioner's "earnings and profits" in the normal manner under established accounting principles. There was no question of deferment of income which would be taxable eventually as in *Commissioner* v. *South Texas Lumber Co., supra.*

Whether the contributions of $971,031.01 constitute part of petitioner's "accumulated earnings and profits" depends not upon whether they were subjected to tax when received by petitioner, as the court below assumed, but, instead, upon whether such amount would be taxable as a dividend in the hands of petitioner's shareholders if distributed.[26]

(a) The term "accumulated earnings and profits", which has the same meaning for both excess profits tax and income tax purposes, is not limited to amounts which have been previously included in taxable income

Section 728 of the Internal Revenue Code provides that the terms used in the excess profits tax subchapter (subchapter E), "shall have the same meaning as when used in chapter 1" (Appendix, *infra*, p. 76), and the regulations promulgated under Section 718(a)(4) (Regulations 112, Section 35.718-2) also prescribe that:

> "* * * In general, the concept of accumulated earnings and profits for the purpose of excess profits tax is the same as for the purpose of the income tax."

That fact was also recognized by this Court in *Commissioner* v. *South Texas Lumber Company, supra*, in which this Court states (at p. 500, footnote 7):

> "The meaning of all terms used in the subchapter dealing with the income tax was expressly made ap-

[26] Assuming that petitioner would have no other surplus available for distribution except that which was created as a result of the receipt of the contributions here involved.

> plicable to terms used in the excess profits subchapter. Section 728, 6 FCA title 26, Section 728. Treasury Regulations 112 provided: '* * *. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax.' Section 35.718-2. See also HR No. 2894, 76th Cong. 3d Sess. 41."

The legislative history of Section 718 indicates that it was the Treasury Department itself which suggested the use of the term "earnings and profits" as a component of equity invested capital in order to take advantage of judicial interpretation which that term had received as a part of the income tax law. The spokesman of the Treasury Department submitted to Congress, at the time that it was considering the Second Revenue Act of 1940, a memorandum entitled "Advantages of the Invested Capital Concept Contained in the Current Excess Profits Tax Proposal over the Invested Capital Concept of the Revenue Act of 1918".[27] The fourth point of that memorandum deals with the concept of earnings and profits, which was subsequently incorporated in Section 718(a)(4) of the Internal Revenue Code, and reads as follows:

> (4) EARNED SURPLUS. The 1918 act provided for the inclusion of earned surplus in invested capital. Much litigation arose concerning the propriety of including various items in determining earned surplus. The current proposal uses the concept of 'earnings and profits' rather than earned surplus. '*Earnings and profits*' *is a term which has been used for many years in the income tax law and which has received lengthy judicial interpretation.* The Bureau records are adequate to reveal the accumulated earnings and profits of corporations." (Emphasis supplied.)

[27] Published in "Joint Hearings before the Committee on Ways and Means, House of Representatives, and Committee on Finance, U. S. Senate," 76th Congress, 3rd Session, page 94.

The use of the term "earnings and profits" in the income tax law, referred to by the Treasury memorandum, is found in Sections 115(a) and (b) of the Internal Revenue Code (Appendix, *infra*, p. 69) and the corresponding sections of prior revenue acts. Section 115(a) defines a taxable "dividend" as follows:

> "(a) Definition of Dividend—The term 'dividend' when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year * * *, without regard to the amount of earnings and profits at the time the distribution was made."[28]

The dividend as defined by Section 115 I.R.C., is includable in the gross income of the recipient under Section 22(a) I.R.C.

Most of the judicial interpretation, referred to by the Treasury spokesman, is found in cases involving questions of whether the distribution of surplus created by the receipt of special types of assets is taxable to the stockholders of the distributing corporation. Those cases turn on the question of whether the surplus created by the receipt of the particular item constitutes "earnings or profits" within the meaning of Sections 115(a) and (b), I.R.C.

Although this Court has frequently dealt with the term "earnings and profits", the cases have always concerned rather narrowly defined aspects of the term. None of them has presented squarely the question as to the extent to which items which are not taxable to the corporation when received are includable in the computation of earn-

[28] The term "earnings and profits" is used interchangeably with the term "earnings or profits". Cf. Sections 115(a) and (b), Revenue Acts of 1928, 1932, 1934, 1936, and 1938, which are published in the Statutes at Large as indicated in the Index, p. VI, *supra*.

ings and profits. Among the questions dealing with earnings and profits which this Court has passed upon, are questions concerning the tax treatment of pre-March 1, 1913 accumulations;[29] distributions in connection with liquidations,[30] and reorganizations;[31] whether a dividend was distributed out of profits of the year 1917 or an earlier year,[32] and whether unrealized profit on installment sales of a taxpayer reporting income on the installment basis is includable in earnings and profits.[33]

The Commissioner's regulations defining "earnings or profits" distinguish between items which are nontaxable and income which is deferred or not recognized. This distinction is readily apparent from the following excerpts from Section 29.115-3 of Regulations 111;[34]

> "* * * a corporation computing income on the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis; and an insurance company subject to taxation under section 204 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 204-(b)(5) and which is segregated accordingly in the unearned premium reserve.

---

[29] *Lynch* v. *Hornby*, 247 U. S. 339; *Peabody* v. *Eisner*, 247 U. S. 347; *Helvering* v. *Canfield*, 291 U. S. 163 and *Foster* v. *United States*, 303 U. S. 118.

[30] *Lynch* v. *Turrish*, 247 U. S. 221; *Commissioner* v. *Wheeler*, 333 U. S. 542.

[31] *Commissioner* v. *Bedford*, 325 U. S. 283; *Commissioner* v. *Fisher*, 327 U. S. 512; *Commissioner* v. *Munter*, 331 U. S. 210 and *Commissioner* v. *Phipps*, 336 U. S. 410.

[32] *Edwards* v. *Douglas*, 269 U. S. 204.

[33] *Commissioner* v. *South Texas Lumber Co.*, *supra*.

[34] The text of this Regulation which is applicable to taxable years beginning after December 31, 1941 and also the text of the corresponding section of the prior regulation is set out more fully in the Appendix, *infra*, pp. 76 to 78.

"Among the items entering into the computation of corporate earnings or profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items deductible in gross income under section 22(a) or corresponding provisions of prior Revenue Acts. *Gains and losses within the purview of section 112 or corresponding provisions of prior Revenue Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section (see section 29.115-12).* Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends." (Emphasis supplied.)

The court below apparently failed to note, with regard to the effect on "earnings and profits" the difference between the receipt of items which are not taxable at any time, and deferred installment profits or unearned premium on insurance or nonrecognized gains and losses within the purview of Section 112 of the Internal Revenue Code or corresponding sections of prior revenue acts.

The Commissioner has consistently maintained that practically everything received by a corporation from any source, except money or property paid in by its own stockholders, is includable in its earnings and profits and constitutes a taxable dividend when distributed to its stockholders.

In *Charles F. Ayer*, 12 B.T.A. 284, 287 (1928), the taxpayer had received a dividend out of a depletion reserve based upon discovery value and contended before the Board of Tax Appeals that such depletion reserve did not constitute part of the earnings and profits of the distributing corporation and, consequently, that the dividend was

not taxable to him. The Board of Tax Appeals rejected this argument, stating (p. 287):

> "This is not the only case where some income or profit free from tax in the hands of a corporation is, nevertheless, taxable to a stockholder upon distribution. *Dividends and stock of domestic corporations, interest on bonds and obligations of States and municipalities, and statutory exemptions are not a part of the statutory net income of a corporation, but are nevertheless a part of its earnings or profits and may form a part of ordinary dividends which are taxable when received by the stockholders.* On the other hand, corporations frequently make expenditures which are not deductible from gross income for income-tax purposes, but which nevertheless reduce earnings or profits. It therefore follows that the earnings or profits mentioned in section 201(a) of the Revenue Act of 1921 are not the equivalent of the taxable net income of the corporation. In this connection see *National Grocery Co.*, 1 B.T.A. 688, and *Lynch* v. *Hornby*, 247 U.S. 339." (Emphasis supplied.)

In *Cummings* v. *Commissioner*, 73 F. 2d 477, 480 (C.C.A. 1st, 1934), the corporation there involved had collected more than $200,000.00 under a life insurance policy on the life of one of its executives and, pursuant to an agreement made at the time that the policy was taken out, deposited the amount in a separate bank account and subsequently distributed the sum to its stockholders as a dividend. The proceeds of the life insurance policy were excluded from the gross income of the corporation under Section 22(b)(1) of the applicable revenue act. The stockholders did not report the dividend as taxable income, contending, among other things, that it did not represent a distribution out of earnings and profits of the corporation within the meaning of Section 115(a) of the Revenue Act of 1928 (45 Stat. 791). The Commissioner insisted that the dividend

represented a distribution out of the earnings or profits of the corporation, and his contention was upheld by the Board of Tax Appeals and by the Court of Appeals for the First Circuit. In answering the taxpayers' argument that the distribution was not made out of earnings or profits of the corporation, the Court of Appeals stated (p. 480):

> "'Earnings or profits' as used in this section must mean the same as 'gains or profits' in section 22(a), *and a gift to a corporation would be a gain.* Nor would it be overstating the transaction here to say, that, the company having invested in the insurance policies by paying the premiums, the receipts therefrom over and above the premiums were profits. *If these funds, however derived, belonged to the company when received, they would go to increase its surplus,* and it cannot be seriously argued that the surplus funds in the hands of the company over and above its stock liability are not the earnings or profits contemplated by the section." (Emphasis supplied.)

The same conclusion was reached by the Court of Appeals for the Third Circuit in *Golden* v. *Commissioner of Internal Revenue*, 113 F. 2d 590 (C.C.A. 3rd, 1940). There the corporation, named as beneficiary of certain life insurance policies, had caused the policies to be deposited in a trust company under an arrangement whereby the trust company would collect the proceeds and distribute them directly to the stockholders of the corporation. The obvious purpose of this arrangement was to avoid having the proceeds of the insurance come into the possession of the corporation and thereby increase the assets of the corporation, and also its surplus or accumulated earnings and profits. Nevertheless, the court of appeals held that the proceeds of the insurance when distributed by the trustee directly to the stockholders represented a distribution out of earnings and profits of the corporation, which

was taxable to the stockholders as a dividend. In reaching its decision, the court stated (p. 591):

> "* * * The second, as might be expected, deals with the next step—transference of the insurance proceeds from the corporation-beneficiary to its stockholders. Now the stockholders do not receive those proceeds 'under a contract of insurance'. The contract goes no further than to create a legal relationship between the insurer, the insured officer, and the beneficiary corporation. The amounts received by the stockholders fall rather into the broad category of dividends. They have accordingly been taxed to the stockholders, despite their physical segregation from the corporate assets coupled with a corporate undertaking (by appropriate resolutions passed prior to the insured officer's death) to pay them over to the stockholders when received. * * *"

The proposition that gifts to a corporation are includable in its "earnings and profits" under Section 115 of the Internal Revenue Code and corresponding sections of prior revenue acts as indicated in *Cummings* v. *Commissioner, supra,* was also impliedly approved by Judge Learned Hand in *Rice* v. *Eisner,* 16 F. 2d 358, 360 (C.C.A. 2nd, 1926), where he stated:

> "The exemption in all the statutes of the corpus of gifts and bequests shows that in the minds of those who drew the acts it was thought open to question whether even this might not be considered income."

Judge Ward, in his dissent in *United States* v. *Oregon-Washington R. & Navigation Company,* 251 Fed. 211 (C.C.A. 2nd, 1918), also expressed the same opinion stating (p. 214):

> "The income tax laws of 1913, 1916 and 1917 expressly provide that only the income of gifts is to be taxed, from which it may be inferred, that but for this provision, the gifts themselves would be taxed as income."

In *Annis Van Nays Schaeppe* v. *Commissioner*, 8 T.C. 1224, *aff'd. per curiam*, 168 F. 2d 284, the Tax Court determined that an increase in the surplus of a corporation which resulted from the successful pleading of the statute of limitations against a creditor constituted earnings and profits within the meaning of Section 115(a) of the Internal Revenue Code, stating (p. 1232):

> "* * * By virtue of the judgment of the California court, the amount of $400,000 was released to the general uses of the building company and its assets, previously offset by the obligation of the note, were made available to the building company. This benefit, we think, is 'earnings and profits' within the meaning of section 115(a). * * *"

The administrative practice has gone so far as to include in "earnings and profits", for the purpose of making up a deficit, gifts made to the corporation by its principal stockholder, which, for excess profits tax purposes, would be classified as paid-in surplus. This is indicated in a ruling published in 1924 which has never been revoked.[35] The official headnote of that ruling reads as follows:

> "Bonds of the M Corporation and interest thereon were contributed to the corporation as gifts by its principal stockholders, the amounts thereof being credited to its surplus account. These contributions were sufficient to wipe out a deficit sustained prior to 1916 and at the time of a dividend payment in 1918 its earnings were in excess of the amount of the dividend and the books reflected a surplus in excess of the amount of the dividend.
>
> "There being no evidence that even a partial liquidation of the assets was contemplated or attempted, the legal presumption that the dividend was paid from surplus profits would apply. It is held that the div-

[35] I.T. 1924, Cumulative Bulletin III-1, p. 27. Cf. *Commissioner* v. *Rosenbloom Finance Corporation*, 66 F. 2d 558 (C. C. A. 3rd, 1933).

idend was a legal dividend and not a return of capital even though the contributions were allowed for excess profits tax purposes as paid-in surplus and its invested capital consequently was not decreased by the operating deficit."

In *Commissioner* v. *F. J. Young Corporation, et al.*, 103 F. 2d 137 (affg. 35 B.T.A. 860), the Court of Appeals for the Third Circuit held that a gain to a corporation, although not recognized under Section 112(b)(5), was, nevertheless, includable in its earnings and profits under Section 115(a) despite the provision to the contrary in the Commissioner's regulations. In order to give legislative sanction to that portion of the regulations which had been overruled by that case,[36] Congress adopted, as Section 501 of the Second Revenue Act of 1940, Sections 115(l) and (m) of the Internal Revenue Code containing a partial definition of earnings and profits. This definition relates principally to the non-recognition provisions of Section 112 and increase in value accrued before March 1, 1913. None of those provisions is relevant here. That partial definition of earnings and profits does not deal with the treatment of items, such as the contributions involved in this case, which are not taxable when received by the corporation.

In *Commissioner* v. *Wheeler, supra*, this Court held that the Commissioner's regulations under Section 115, which prohibited the inclusion in earnings and profits of gains or losses which have not been recognized under Section 112, were valid in the form in which they existed before the adoption of the 1940 Amendment, stating (p. 545):

"Although the term 'earnings and profits' has long been in the revenue acts, in connection with the definition of dividend it has never been defined by the

[36] H.R. Rep. No. 2894, 76th Congress, 3rd Session (C.B. 1940-2, pp. 496, 526). The text of Section 115(l) and (m) is set out in the Appendix, *infra*, pp. 70, 71.

statutes (except in so far as § 501 (a) of the Second Act of 1940 has now done so). But under the Revenue Act of 1934 and succeeding acts, the Commissioner dealt by regulation with that portion of the problem of definition relevant here. Article 115-3 of Treasury Regulations 101, promulgated under the 1938 Act, provided in part as follows: 'Gains and losses within the purview of Section 112 or corresponding provisions of prior Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section.' This regulation, if valid, disposes of the controversy, for when the corporation sold its securities acquired from the Wheelers it realized gain, based on transferor's cost, which was fully recognized under § 112."

* * * * * * *

(p. 547)

"We therefore think that on principles often reiterated the regulation is valid and decisive of this issue. There is no necessity to predicate the determination of deficiency on the 1940 amendment. * * *" (Footnotes omitted.)

The Commissioner's regulations and the cases holding that items which are not taxable to the corporation when received, nevertheless, enter into the computation of its "earnings and profits", still stand. The decision of the court below, by excluding from "earnings and profits" items which are not taxable to the corporation when received, in effect, overrules that portion of the regulations and immunizes the surplus created by the receipt of such items when distributed to stockholders of a corporation as a dividend. This, we submit, was not the holding of this Court in *Commissioner* v. *South Texas Lumber Co., supra.* Therefore, it is clear that the Court of Appeals erred in holding that the contributions of $971,031.01 are not in-

cludable in petitioner's "accumulated earnings and profits" because they had not been previously included in petitioner's taxable income.

(b) The surplus created by the receipt of the contributions in the amount of $971,031.01 was available for and could be distributed as dividends by petitioner

There can be no question that the receipt of the cash and property other than cash in the aggregate amount of $971,031.01 increased petitioner's surplus by a corresponding amount. Petitioner received outright title to the two buildings and included them in its building account on the asset side of its balance sheet. It also received outright the cash and included that cash in its general cash account on the asset side of its balance sheet. The total increased its assets over its liabilities, including capital stock, by the amount of $971,031.01. That excess of assets over liabilities represented surplus or undivided profits as indicated by this Court in *Willcuts* v. *Milton Dairy Co.*, 275 U.S. 215, in which it stated (at p. 218):

> "* * * Both these terms [surplus and undivided profits] as commonly employed in corporate accounting denote an excess in the aggregate value of all the assets of a corporation over the sum of all its liabilities, including capital stock."

The authors of accounting and financial texts agree that the surplus created by the receipt of contributions of the nature of those involved here is available for distribution as a dividend after the conditions prescribed in the contracts have been fulfilled (*supra*, pp. 31, 32). Here, all conditions prescribed in the contracts with the contributing groups had been completely fulfilled with the exception of four instances.[37] However, in those four instances, too,

[37] R. 95-97; 101-103; 105; 108-109.

petitioner held clear title to the money and property subject only to the condition that the new or enlarged plant be operated in good faith for the specified period of time. Under well established principles, the increment resulting from the receipt of the money and property in those four instances belonged to petitioner."

Under the law of the State of New York, the State in which the petitioner is incorporated, the petitioner would have been free to distribute its entire surplus, including the surplus created by the receipt of the amount of $971,031.01, if its board of directors had decided to make such a distribution. This follows from Section 58 of the Stock Corporation Law of the State of New York.[39] Under that provision, a corporation is merely prohibited from declaring and paying dividends which impair its capital and which do not leave assets at least equalling the aggregate amount of all liabilities including the capital. Cf. *Randell*

---

[38] For example, in *North American Oil Consolidated* v. *Burnet*, 286, U. S. 417, this Court stated (p. 424):

> "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

In *Commissioner* v. *Wilcox*, 327 U. S. 404, 408, this Court stated:

> "• • • a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain, and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain."

If this Court should conclude that the increment resulting from the receipt of the money and property in the four instances in which the condition subsequent had not been fulfilled, at the beginning of the first taxable year here involved, is not includable in petitioner's "earnings and profits", that conclusion would not justify the exclusion of the entire amount of $971,031.01 as the Court of Appeals did. *Helvering* v. *Taylor*, 293 U. S. 507, 515, 516.

[39] As amended in 1938 and 1939, c. 59 of the Consolidated Laws of New York (Appendix, *infra*, p. 831).

v. *Bailey*, 23 N.Y.S. (2d) 173, *aff'd.* 288 N.Y. 280, 43 N.E. (2d) 43 (1942).

It is true that this Court stated in *Edwards* v. *Cuba Railroad Company*, *supra*, that the contract with the Republic of Cuba did not "indicate that the money subsidies were to be used for the payment of dividend, interest or anything else properly chargeable to and payable out of earnings and income". However, it appears that this statement pertained to the analysis of the nature of the subsidies; namely, whether they were contributions to income (and taxable as income), or contributions to capital (and not taxable as income). The distinction between the two types of subsidies was clearly indicated by this Court in *Texas & Pacific R. R. Co.*, v. *United States*, *supra*, and extensively discussed by the Board of Tax Appeals in *Lykes Bros. Steamship Co., Inc.*, *supra*.

In *Burke* v. *Southern Pacific Railroad Co.*, 234 U.S. 669, 680, this Court characterized the grants or subsidies to the railroad there involved as having been "earned" after the company had complied with the terms of the act granting the subsidies, stating (at p. 680):

> "* * * And when, by constructing the road and putting it in operation, the company performed its part of the contract, it became entitled to performance by the government. In other words, it earned the right to the lands described. * * *"

See also *Louisville & Nashville R. R. Co.* v. *United States*, 267 U.S. 395, 402.

Petitioner did not obligate itself not to use the surplus created by the receipt of the contributions here involved for the distribution of dividends. The receipt of such contributions increased petitioner's surplus. That surplus was available for dividend distribution.

(c) Since any distribution of the surplus created by the receipt of the contributions in the amount of $971,031.01 would constitute a taxable dividend to petitioner's stockholders, the amount is part of petitioner's "earnings and profits" and is includable in its invested capital

While there is no decision directly holding that the distribution of surplus, created by the receipt of contributions of the nature of those involved here, is taxable to the stockholders of the distributing corporation, nevertheless it seems clear that the Commissioner would tax such a distribution to the stockholders. The whole tenor of his regulations under Section 115, the administrative practice as reflected in I. T. 1924, *supra*, and the principles laid down by this and other Courts indicate that surplus created by the receipt of tangible items having real value, such as the money and property involved here, may not be distributed to the stockholders free of tax[40] merely because such items were not subjected to tax when received by the corporation.

The applicable principle has been summarized by this Court in *Commissioner* v. *Phipps*, 336 U.S. 410, where, in discussing the Sansome Rule, this Court stated:

> "* * * The Sansome rule itself, as applied to earnings and profits, has never been thought to be controlled by ordinary corporate accounting concepts; its uniform effect is to treat for tax purposes *as earnings or profits* assets which are properly considered *capital* for many if not most corporate purposes, and it has long been a commonplace of tax law that similar divergences often occur. (Citing cases.)
>
> "Congress has expressed its purpose to tax all stockholders who receive distributions of earnings and profits. * * *" (Emphasis supplied.)

The contributions here involved are comparable to the insurance proceeds involved in *Cummings* v. *Commissioner*, *supra*, and *Golden* v. *Commissioner*, *supra*. Both are tan-

[40] And applied to the reduction of the basis of the stock only.

gible items of unquestioned value which increased the assets of the receiving corporation and thereby increased its surplus. The fact that the insurance proceeds were not subject to tax in the hands of the two corporations, did not immunize in the hands of the stockholders the distribution of the surplus created by the receipt of such proceeds. The same reasoning would apply here. Any distribution of the surplus created by the receipt of the contributions in the amount of $971,031.01 would be taxed to petitioner's stockholders as a dividend.

In order to sustain such a tax, the Commissioner would have to determine that the amount of $971,031.01 was includable in petitioner's "earnings and profits" under Section 115 of the Internal Revenue Code. If the contributions are includable in petitioner's "earnings and profits" under Section 115 of the Internal Revenue Code, they are also includable in petitioner's invested capital as part of its "accumulated earnings and profits" under Section 718 (a)(4) of the Internal Revenue Code.

When introduced in 1940, the excess profits tax was intended to prevent any undue enrichment under the rearmament program.[41] The contributions here involved have no reference to the rearmament program. They were received prior to, and most of them many years prior to, the year 1940, the first year for which the excess profits tax was levied. If the contributions in question are not included in petitioner's equity invested capital, either as contributions to its capital or as a part of its accumulated earnings and profits, the income which was earned by the employment of those contributions will be taxed as excess profits, although, in fact, such income is merely the normal

---

[41] See the outline of the legislative history of the 1940 law, with references to the message of the President and statements made in Congressional reports, in 7A Mertens, *Law of Federal Income Taxation* (1943), pp. 19 to 25.

return on "working capital" actually employed in the business.[42]

Therefore, the decision of the court below on the invested capital issue was wrong and should be reversed.

II. The Depreciation Issues

(1) The contributions of cash and property other than cash in the aggregate amount of $971,031.01 should not be eliminated from petitioner's "basis" for depreciation because petitioner is entitled to the "substituted basis" provided by Section 113, I.R.C.

The petitioner took deductions for depreciation on the two buildings which it received from the community groups and on its full cost of the buildings and machinery in the factories located in the communities from which it had received cash contributions. These deductions were allowed by the Commissioner until the beginning of the first of the two taxable years here involved. For the two years here involved, the Commissioner disallowed depreciation on the two factory buildings and he also disallowed a portion of the depreciation deducted by the petitioner on the factories located in the communities from which petitioner had received cash contributions, representing what he considered to be the depreciation on that part of the buildings and machinery which might have been acquired with the contributed cash (R. 31, 32, 115).

The Tax Court sustained the Commissioner's disallowance of depreciation on the two buildings received directly from two of the community groups (R. 25), but found that the buildings and machinery in the new or enlarged factories in the communities from which petitioner had received cash contributions had "cost" to petitioner, and

[42] See Montgomery's *Federal Taxes on Corporations* (1945-1946), Vol. 2, p. 383.

that the Commissioner was not justified in reducing that "cost" for the purpose of computing depreciation (R. 25, 26).

The court of appeals reversed the Tax Court's finding that the buildings and machinery in the factories located in the communities from which petitioner had received cash contributions had "cost" to the petitioner as "clearly erroneous" under Rule 52(a) of the Federal Rules of Civil Procedure on the ground that "cost means cost to the taxpayer" (R. 153). It sustained the Tax Court's decision that petitioner was not entitled to depreciation on the two buildings received directly from the two community groups on the ground that "under the Statute, 26 U.S.C.A. Section 114, depreciation is allowable only on the cost to the taxpayer of the property" (R. 160).

At all times material to the issues in this case, Section 23(l)[43] of the Internal Revenue Code has provided for a reasonable allowance for depreciation on property used in the taxpayer's trade or business. Section 23(n), I.R.C., provides that the basis upon which the depreciation is to be allowed shall be as provided in Section 114, I.R.C. The latter section provides that the basis for depreciation shall be the adjusted basis of Section 113(b) for the purpose of computing the gain upon the sale or other disposition of the property. Section 113(b) provides that the adjusted basis for determining the gain or loss from the sale or other disposition of the property "shall be the basis determined under subsection (a), adjusted as hereinafter provided."

Thus, the petitioner's right to deduct depreciation on the properties here in controversy depends upon Section 113(a), which provides that "the basis of property shall be the cost of such property; *except that* —

---

[43] The text of this and the other sections of the Internal Revenue Code referred to here will be found in the appendix, *infra*, pp. 67 to 69.

"(2) * * * If the property was acquired *by gift after December 31, 1920*, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, * * *

"(8) * * * If the property was acquired after December 31, 1920, by a corporation—

(B) as paid-in surplus or *as a contribution to capital*,

then the basis shall be the same as it would be in the hands of the transferor, * * * " (Emphasis supplied.)

If this Court concludes that the contributions of cash and property in the aggregate amount of $971,031.01 were received by petitioner as a contribution to capital, as urged by petitioner (pp. 14 to 36, *supra*), it follows that petitioner is entitled to use the transferor's basis for the purpose of computing depreciation. That basis has been stipulated for the two buildings (R. 32). The cash is itself the measure of the transferor's basis for the cash contributions.

If this Court should conclude that the contributions in question represent gifts but not contributions to capital within the meaning of Section 113(a)(8), then the petitioner is still entitled to the transferor's basis under Section 113(a)(2), I.R.C.

The legislative history of the "substituted basis"[44] provisions of Sections 113(a)(2) and 113(a)(8) indicates that those provisions were intended to prevent the donee or transferee from using a "stepped-up basis," as the courts had held that he could do prior to the amendment of the

[44] The term is defined in Section 113(b)(2), I.R.C., Appendix, *infra*, p. 68.

law.[45] The requirement that the donee must use the donor's basis in the case of gifts was first adopted as Section 202(a)(2) of the Revenue Act of 1921, 42 Stat. 227, and has been continued since that time. The Commissioner's regulations applied that provision to property paid-in to a corporation as paid-in surplus. However, in *Rosenbloom Finance Corporation*, 24 B.T.A. 763, the Board of Tax Appeals held that property contributed to a corporation by the majority stockholder and taken up on the books of the corporation as paid-in surplus was not a gift within the meaning of Section 204(a)(2) of the Revenue Act of 1924, which corresponds to Section 202(a) of the 1921 Act, and that the receiving corporation was not restricted to the transferor's basis.

On appeal, the Court of Appeals for the Third Circuit held that such a transfer by the majority stockholder to the corporation was a gift and that the corporation was limited to the transferor's basis for the purpose of computing gain or loss upon the sale of the property.[46] However, the decision of the Board of Tax Appeals in the *Rosenbloom Finance Corporation* case, *supra*, led to the adoption of Section 113(a)(8) of the Revenue Act of 1932, which has been continued in each of the succeeding revenue acts and is the same as Section 113(a)(8) of the Internal Revenue Code.[47]

There is no suggestion in the legislative history nor in any of the court decisions which preceded the adoption of

---

[45] 3 Mertens, *Law of Federal Income Taxation*, Section 21.105, footnote 8 sets out provisions of the Committee reports which led to the substituted basis provisions incorporated in Section 113(a)(8), and Section 21.39 sets out the reasons which led to the substituted basis provisions of Section 113(a)(2).

[46] 66 F. 2d 556 (1933); *cert. den.* 290 U.S. 692.

[47] H.R. Rep. No. 708, 72nd Cong., 1st Sess., p. 21; Senate Rep. No. 665, 72nd Cong., 1st Sess., pp. 27-28; H.R. Rep. No. 1492, 72nd Cong., 1st Sess., p. 13.

the "substituted basis" provisions of Sections 113(a)(2) and 113(a)(8) that the donee or transferee is not entitled to any basis for a computation of gain or loss, or for the computation of depreciation, on property received as a gift or as a contribution to capital. The sole concern was to limit the donee's basis to the basis in the hands of the donor or transferor.

Prior to the decision of this Court in *Detroit Edison Company* v. *Commissioner*, *supra*, the administrative practice of the Bureau was to allow depreciation on such property including property received as a contribution under circumstances similar to those involved here. In *Frank Holton Co.*, *supra*, the Board of Tax Appeals noted that the Commissioner had allowed depreciation on the building there involved for the period of time after title had been transferred to the taxpayer. Here depreciation was allowed on the two contributed buildings and on the other property up to the beginning of the first of the two taxable years now before the Court.

The Commissioner now takes the position that, in effect, the decision of this Court in the *Detroit Edison Company* case abrogated the "substituted basis" provisions of Section 113(a), I.R.C. Petitioner submits that this Court did not make any such sweeping determination in that case. There, this Court determined that amounts paid by the consumers to the utility company were neither gifts nor contributions to capital, stating that (p. 102):

> "It overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company * * *"

This Court found that the "payments were to the customers the price of the service" and that, consequently,

the utility company was not entitled to the substituted basis provisions of Sections 113(a)(2) or (8).

Here, it does not overtax imagination to regard either the community groups or the individual contributors comprising those groups as makers of either donations or contributions to the petitioner. No individual contributor or community group was buying anything from the petitioner. The contributions were made voluntarily. The makers intended to transfer to petitioner an economic benefit or gain, and the petitioner was to have and retain title to it.

We submit that the decision of this Court in the *Detroit Edison Company* case has no more application to gifts coming under Section 113(a)(2), or contributions to capital coming under Section 113(a)(8) than it has to devises coming under Section 113(a)(5). In rejecting an argument of the Commissioner that the devisee was not entitled to depreciation on inherited property because such property had no "cost," the Tax Court stated in *Charles B. Currier et ux* v. *Commissioner*, 7 T.C. 980, 984:

> "The basis of inherited property is accordingly not cost, as it was in the *Detroit Edison* and *Reisinger* cases, and to say that a property cost the taxpayer nothing makes no contribution to the solution of the present question. As opposed to cost, the basis of property acquired by devise is categorically fixed by statute as fair market value on the date of acquisition. Internal Revenue Code, Section 113(a)(5)."

The argument that the decision of this Court in the *Detroit Edison Company* case has limited the basis of depreciation to "cost to the taxpayer" was advanced on behalf of the Commissioner in *Commissioner* v. *McKay Products Corporation*, *supra*, just as it was in the instant case, but was rejected by that Court for the reasons submitted by the petitioner here. The reasoning of the Court on this point

in the *McKay Products Corporation* case is as follows (p. 643):

> "Detroit Edison Co. v. Commissioner, 319 U.S. 98 (1943) was relied upon by the Tax Court for its conclusion. If it is in point it controls. But we think it is not our case. In the Detroit Edison case, the taxpayer charged consumers for the cost of extending electric current distribution facilities and claimed as a base for computing its depreciation the full cost of the installations. The Court held that funds so paid by consumers to the taxpayer utility were neither gifts nor contributions to capital. "It is enough to say that it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company. * * * The payments were to the customer the *price of the service.* [Emphasis added.] 319 U. S. at 102-103.
>
> "We think that what is significant is that the Detroit Edison Co. was in the business of selling electric power to the very persons whose payments it sought to depreciate, and that it was Detroit Edison's policy to deliver power to outlying areas only if the consumer bore the cost of the line extension. The matter is really summed up in the Court's statement that payments were part of the price of the service."
>
> * * * * *
>
> "* * * Looking as they do toward business continuity, the Internal Revenue Code's depreciation provisions—and especially those which provide for a substituted rather than a cost basis—would seem to envision allowance of a depreciation deduction in situations like this. We think that this transfer entitled the taxpayer to its donor's basis under Section 113(a)(2), and furthermore, for the reasons given in the discussion above of the excess profits tax problem, that the same conclusion follows under Section 113(a)(8) * * * "

Petitioner submits that the reasoning of the Court set forth above is correct and is applicable to the contributions

of money and property here involved. The contributions here involved were made by individuals and groups who knew what they were doing; who intended to convey full and complete title to petitioner; who intended that petitioner should enjoy the economic benefit so conveyed and who were not purchasing any service or right other than the intangible satisfaction derived from the improvement in the general welfare of the community. The same kind of satisfaction is derived by every contributor to a community chest or educational institution designed to improve the general welfare of the community. Congress intended and specifically provided that the donee or transferee of such a contribution should have the "substituted basis" provided in Section 113(a) of the Internal Revenue Code. The decision of the court below holding to the contrary is clearly wrong and should be reversed.

(2) The court below was not justified in setting aside as "clearly erroneous" the finding of the Tax Court that the buildings and machinery were paid out of petitioner's own unrestricted funds and that such buildings and machinery had a "cost" basis to petitioner.

The Tax Court refused to approve the Commissioner's disallowance of a portion of petitioner's depreciation on the factories located in the communities from which petitioner had received cash contributions, stating (R. 25-26):

> . . . However, no justification appears for the action of the Commissioner in disallowing depreciation on buildings, machinery and equipment upon the theory that the petitioner used cash received from the various communities to pay for those buildings and that machinery, and, consequently, the buildings and machinery had, to that extent, no cost to the petitioner. The parties have stipulated that the cash was not earmarked in any way and it is just as reasonable to as-

sume that it was used for any one of a dozen other purposes as it is to make the Commissioner's assumption. The petitioner paid for the buildings and machinery out of its own unrestricted funds, those buildings and that machinery had cost to it, as shown on its books and records, and it is entitled to depreciation thereon."

The court below set aside this finding as "clearly erroneous" under Rule 52(a) of the Federal Rules of Civil Procedure, stating that (R. 154):

> "the Tax Court committed a clear mistake of law and fact when it concluded that the application of the donated funds to the cost of the factories and machinery depended upon the taxpayer's accounting system, . . ."

The petitioner submits that Judge Murdock, who heard the case in the Tax Court, did not commit a clear mistake of law and fact. The stipulation of the parties, including the exhibits attached thereto, clearly support Judge Murdock's finding. It is significant that the same judge made a finding to the contrary in the case of *C. L. Downey Co.*, 10 T.C. 837, *aff'd.* 172 F. 2d 810, which involved a transaction of the same general nature as in the instant case. His observation that the contributed cash might have been used for any one of a dozen other purposes is supported by the observation of this Court in *Edwards* v. *Cuba R.R. Co.*, *supra*, where, in referring to the purpose for which public and private subsidies had been given to railroads in this country, this Court stated (p. 632):

> "Usually they are given to promote settlement and to provide for the development of the resources in the territory to be served. The things so sought to be attained in the public interest are numerous and varied."

The same statement is applicable to the cash contributions here involved. In holding that such contributions were not given solely for the acquisition of buildings and machinery, Judge Murdock is fully supported by the record which shows that petitioner found it necessary to train new employees for employment in the new or enlarged factories at a cost of not less than $100 for each employee, and also found it necessary to provide opening inventories with which to operate the factories (R. 32-33; 119). Even in those instances where the contracts provided that the cash contribution was to be used for buildings and equipment, the petitioner had to provide many other things, such as insurance on the plant, opening inventories with which to operate the plant and it also had to train new employees. Obviously the Tax Court had these other obligations in mind when it made the finding objected to by the court below.

The petitioner submits that the following statement in a recent decision of this Court [48] is applicable to the situation in the instant case:

> "* * * While, of course, it would be our duty to correct clear error, even in findings of fact, the Government has failed to establish any greater grievance here than it might have in any case where the evidence would support a conclusion either way but where the trial court has decided to weigh more heavily for the defendants. Such a choice between two permissible views of the weight of evidence is not 'clearly erroneous'."

The fact that the Tax Court has decided to weigh more heavily for petitioner on this point in choosing between two permissible views of the weight of the evidence does not make its finding "clearly erroneous". The findings of the Tax Court on this point should be reinstated, if this Court

---

[48] United States v. Yellow Cab Company, — U.S. — (December 5, 1949).

should not accept the petitioner's principal contention that the contributions of cash and property represented contributions to capital or gifts entitling the petitioner to the basis of the donor or transferor for the purpose of computing depreciation.

(3) **If the cash contributions are to be used to reduce petitioner's basis for depreciation, such contributions should be allocated not only to the cost of land, buildings and machinery but also to the cost of training new employees and the cost of providing opening inventory with which to operate the new or enlarged factories.**

All of the contracts between petitioner and the contributing groups contemplated the operation of the new or enlarged factory in the particular community and the employment of local employees and not merely the construction or acquisition of the particular factory and machinery. The parties stipulated before the Tax Court that petitioner found it necessary to train new employees for employment in the new or enlarged factories, and also found it necessary to supply the new or enlarged factories with opening inventory. The cost of training the new employees and the cost of the opening inventories were also stipulated (R. 32, 33, 119).

Petitioner contended, in the alternative, before the Tax Court, before the Court of Appeals and is so contending before this Court that if the cash contributions are to be allocated to buildings and machinery for the purpose of reducing petitioner's basis for depreciation, as the Commissioner has done, then such cash contributions should be allocated, not only to the building, machinery, and land (in instances where land was acquired) but also to the cost of training new employees and the cost of providing the opening inventories necessary to operate the new or enlarged factories. The amount of each contribution allocable to

cost of training new employees and the cost of providing opening inventory was stipulated as Exhibit 20-T in the stipulation filed with the Tax Court (R. 32-33; R. 119).

If this Court should deny petitioner the use of the transferor's basis for the purpose of computing depreciation and should approve the lower court's action in going behind petitioner's cost as determined by the Tax Court, then petitioner submits that the Court should direct that the contributions be allocated to all of the items for which they were made on the basis of the stipulation filed with the Tax Court.

CONCLUSION

The decision of the Court of Appeals for the Eighth Circuit is wrong and should be reversed.

Respectfully submitted,

CHARLES B. MCINNIS,
ERNEST M. CALLOMON,
Mayflower Office Building,
Washington 6, D. C.,
Attorneys for Petitioner.

Of Counsel:
ROBERTS & MCINNIS,
Mayflower Office Building,
Washington 6, D. C.

APPENDIX

Statutes and Regulations Applicable During the Taxable Years Ending October 31, 1942, and October 31, 1943.

Internal Revenue Code:

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

. . . . . .

(l) [as amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business . . .

. . . . . .

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

. . . . . .

(26 U.S.C. 1946 ed., Sec. 23.)

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

. . . . . .

(2) *Gifts after December 31, 1920.*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the

hands of the donor or the last preceding owner by whom it was not acquired by gift, except that . . .*

* * * * * * *

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined upon subsection (a), adjusted as hereinafter provided.

* * * * * * *

(2) *Substituted basis.*—The term "substituted basis" as used in this subsection means a basis determined under any provision of subsection (a) of

---

*The portion of Section 113(a)(2) as set out above was in effect during both taxable years here involved. The remaining portion of the provision which was changed by Section 143(a) of the Revenue Act of 1942 (effective as to taxable years beginning after December 31, 1941, pursuant to Section 101 of that Act), is omitted because it has no bearing on the issues of this case.

this section or under any corresponding provision of a prior income tax law, providing that the basis shall be determined—

(A) by reference to the basis in the hands of a transferor, donor, or grantor, or

(B) by reference to other property held at any time by the person for whom the basis is to be determined.

Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, then the adjustments provided in paragraph (1) of this section shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases.

(26 U.S.C. 1946 ed., Sec. 113)

Sec. 114. Basis for Depreciation and Depletion.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

. . . . . .

(26 U.S.C. 1946 ed., Sec. 114.)

Sec. 115. Distributions by Corporations.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter . . . means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year

(computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made . . .

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113 . . .

* * * * * * *

(l) [As added by Sec. 501(a), Second Revenue Act of 1940, c. 757, 54 Stat. 974, and amended by Sec. 146(a) of the Revenue Act of 1942, c. 412, 56 Stat. 798] *Effect on Earnings and Profits of Gain or Loss and of Receipt of Tax-Free Distributions.*—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

(1) for the purpose of the computation of earnings and profits of the corporation, shall be determined, except as provided in paragraph (2), by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(2) for the purpose of the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. Where in determining the adjusted basis used in computing such realized gain or loss the adjustment to the basis differs from the adjustment proper for the purpose of determining earnings or profits, then the latter adjustment shall be used in determining the increase or decrease above provided. For the purposes of this subsection a loss with respect to which a deduction is disallowed under section 118, or a corresponding provision of a prior income-tax law, shall not be deemed to be recognized. Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

(1) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made.

(2) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received.

(m) [As added by Sec. 501(a), Second Revenue Act of 1940, c. 757, 54 Stat. 974] *Earnings and Profits—Increase in Value Accrued Before March 1, 1913.*—

(1) If any increase or decrease in the earnings or profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2), an increase (properly reflecting such difference) shall be

made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(2) If the application of subsection (1) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (1) and in lieu of the rule provided in paragraph (1) of this subsection, the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

Sec. 712. Excess Profits Credit—Allowance [Added by Sec. 201, 2nd 1940 Act; amended by Sec. 13, Excess Profits Tax Amendments of 1941].

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess profits credit in case of certain reorganizations of corporations, see section 741.)

* * * * * * *

(26 U.S.C. 1946 ed., sec. 712(a))

Sec. 714. Excess Profits Credit—Based on Invested Capital.

The excess profits credit, for any taxable year, computed under this section, shall be the amount shown in the following table:

If the invested capital for the taxable year, determined under section 715, is:	The credit shall be:
Not over $5,000,000	8% of the invested capital
Over $5,000,000	$400,000, plus 7% of the excess over $5,000,000.

(as in force during fiscal year ended October 31, 1942)

Sec. 714. Excess Profits Credit—Based on Invested Capital. [as amended by Section 217, Revenue Act of 1942]

The excess profits credit, for any taxable year, computed under this section, shall be the amount shown in the following table:

If the invested capital for the taxable year, determined under section 715, is:	The credit shall be:
Not over $5,000,000	8% of the invested capital.
Over $5,000,000, but not over $10,000,000	$400,000, plus 7% of the excess over $5,000,000.
Over $10,000,000, but not over $200,000,000	$750,000, plus 6% of the excess over $10,000,000.
Over $200,000,000	$12,150,000, plus 5% of the excess over $200,000,000.

(as in force during fiscal year ended October 31, 1943)

Sec. 717. DAILY INVESTED CAPITAL [Added by Section 201, Second Revenue Act of 1940].

The daily invested capital for any day of the taxable year shall be the sum of the equity invested capital for such day plus the borrowed invested capital for such day determined under section 719.

Sec. 718. [As added by Sec. 201, Second Revenue Act of 1940, supra] Equity Invested Capital.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money Paid In.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) *Property Paid In.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined in the same manner as if the property were still held at the beginning of such taxable year. If such unadjusted basis is a substituted basis it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113(b)(2);

* * * * * * *

(4) *Earnings and Profits at Beginning of Year.*—The accumulated earnings and profits as of the beginning of such taxable year;

* * * * * * *

(as in force during fiscal year ended October 31, 1942)

Sec 718. [As added by Sec. 201, Second Revenue Act of 1940, supra] Equity Invested Capital.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money Paid In.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) [as amended by Sec. 218, Revenue Act of 1942, c. 619, 56 Stat. 798] *Property Paid In.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115(l) for determining earnings and profits;

. . . . . .

(4) *Earnings and Profits at Beginning of Year.*—The accumulated earnings and profits as of the beginning of such taxable year;

. . . . . .

(as in force during fiscal year ended October 31, 1943)

Sec. 719. Borrowed Invested Capital [Added by Section 201, Second Revenue Act of 1940].

(a) *Borrowed Capital.*—The borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus, . . .

. . . . . .

(b) *Borrowed Invested Capital.*—The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 50 per centum of the borrowed capital for such day.

Sec. 728. Meaning of Terms Used [Added by Sec. 201, 2nd 1940 Act].

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

TREASURY REGULATIONS

Treasury Regulations 103, issued under the Internal Revenue Code, as in effect during the taxable year ended October 31, 1942:

Sec. 19.113(a)(8)-1.[23] *Property acquired by a corporation after December 31, 1920.*—. . .

In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, or from any person as a contribution to capital, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift the basis thereof shall be determined under section 113(a)(2).

. . . . . .

Sec. 19.115-3. *Earnings or Profits.*—In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and mere bookkeeping en-

[23] Section 29.113(a)(8)-1 of Treasury Regulations 111, promulgated under the Internal Revenue Code, as in effect during the taxable year ended October 31, 1943, is identical with Section 19.113(a)(8)-1 of Regulations 103.

tries increasing or decreasing surplus will not be conclusive. Among the items entering into the computation of corporate earnings or profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22(a), or corresponding provisions of prior Revenue Acts. Gains and losses within the purview of section 112 or corresponding provisions of prior Revenue Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section. Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

Treasury Regulations 111, promulgated under the Internal Revenue Code, as in effect during the taxable year ended October 31, 1943:

Sec. 29.115-3. *Earnings or Profits.*—In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be conclusive, the amount of the earnings or profits in any case will be dependent upon the method of accounting properly employed in computing net income. For instance a corporation keeping its books and filing its income tax returns under sections 41, 42, and 43 on the cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation computing income on the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis; and an insurance company subject to taxation under section 204 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 204(b)(5) and

which is segregated accordingly in the unearned premium reserve.

Among the items entering into the computation of corporate earnings or profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22(a) or corresponding provisions of prior Revenue Acts. Gains and losses within the purview of section 112 or corresponding provisions of prior Revenue Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section (see section 29.115-12). Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

Treasury Regulations 109, promulgated under the Internal Revenue Code, as in force during the taxable year ended October 31, 1942:

Sec. 30.718-1.[49] *Determination of daily equity invested capital—Money and property paid in.*— . . .

If the property was acquired after December 31, 1929, by a corporation from a shareholder as paid-in surplus or from any person as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made. (See section 113(a)(8).)

Sec. 30.718-2. *Determination of daily equity invested capital—Accumulated earnings and profits*— (a) *In general.*—The term "accumulated earnings and profits" is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and section 30.718-4 as

[49] Section 35.718-1 of Treasury Regulations 112, promulgated under the Internal Revenue Code, as in force during the taxable year ended October 31, 1943, is identical with Section 30.718-1 of Regulations 109.

to the effect of the declaration and distribution of dividends. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax. . . .

Treasury Regulations 112, promulgated under the Internal Revenue Code, as in force during the taxable year ended October 31, 1943:

SEC. 35.718-2. *Determination of Daily Equity Invested Capital—Accumulated Earnings and Profits.* (a) *In general.*—The term "accumulated earnings and profits" is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and section 35.718-5 as to the effect of the declaration and distribution of dividends. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax. . . .

G.C.M. 16952

(Cumulative Bulletin 1937-1, page 133)

REVENUE ACTS OF 1932 AND 1934

Where a contract was entered into on behalf of a group of citizens with a manufacturing company in order to induce it to locate its plant on certain property, and pursuant thereto such property was conveyed to the company when its pay roll reached a stipulated amount, the grantee did not derive taxable income from such conveyance, nor was the transfer by the grantor subject to the gift tax.

Advice is requested whether the value of property conveyed to the M Company by a group of citizens to induce the company to locate its business on the property constituted taxable income, and whether the transfer of the property was subject to the Federal gift tax.

By virtue of a proceeding held in the chancery court in the city of R, the O Bank, as trustee, took over certain property in trust for the benefit of the citizens of the city of R, who contributed the sum of 6x dollars for the purchase price of the property, factory, machinery, etc. In accordance with the authority conferred upon the O Bank as trustee, it entered into a contract with the M Company and delivered to that company possession of the real estate, factory, machinery, and equipment. In consideration of the surrender of the possession of the property by the trustee, the M Company agreed to pay to the trustee a sum equal to 6 per cent of 6x dollars per annum, or .36x dollars, for a period of 10 years; to pay all State, county, and municipal taxes upon the property; to keep the building, machinery, and equipment insured against loss by fire; and to provide for and pay all items of maintenance and upkeep upon the premises. The M Company also agreed that it would operate the manufacturing plant in the city of R and would not remove the plant therefrom; that the plant would be operated for a period of 10 years; and that if the company ceased operations and the plant was closed for a period of six months, the trustee had the option to terminate the contract and take possession of the premises. The company agreed further that it would operate the plant for all practical purposes as if it were its own, that it would manufacture and market certain articles therein, adequately finance the same, and provide for the purchase of such materials and pay for such labor as was necessary for its operation, the trustee reserving the right to inspect the property and to have such control over the property as a lessor under the laws of the State of S would have over property in the possession of a lessee. In consideration of the covenants and agreements recited in the contract to be performed by the M Company, the trustee agreed that if and when the aggregate annual pay roll of the company in the city of R should equal or exceed the amount of 200x dollars the trustee would deed the property to the M Company in fee simple free and clear of any further charges. When the pay roll of the M Company reached the 200x dollar annual requirement in 1935, the trustee by proper deed transferred the premises in question to that company. The issue presented is the

proper treatment of the transaction for Federal income and gift tax purposes.

In *Edwards* v. *Cuba Railroad Co.* (268 U.S., 628, T.D. 3728, C.B. IV-2, 122), the United States Supreme Court held that subsidy payments made by the Republic of Cuba to a railroad company for the construction and maintenance of a railroad are reimbursements for capital expenditures and are not income, gains, or profits within the meaning of the sixteenth amendment to the Constitution. In several cases the Board of Tax Appeals has followed what it deems to be the principle of the Supreme Court's decisions relative to contributions to corporations generally. In *Appeal of Liberty Light & Power Co.* (4 B.T.A., 155, acquiescence, C.B. VI-1, 4), the Board held that reimbursements for service extensions and connections by utilities did not constitute taxable income. In G.C.M. 1581 (C.B. VI-1, 197), it was held, on authority of the foregoing decisions, that a demonstration plant erected by a foreign corporation at its expense on the taxpayer's premises and transferred to the taxpayer without cost did not constitute taxable income to the taxpayer. In *Frank Holton & Co.* v. *Commissioner* (10 B.T.A., 1317, acquiescence, C.B. VII-2, 18), it was held that the value of property conveyed to a company by business men or a chamber of commerce to induce it to locate its business on the property did not constitute taxable income. In a long line of cases from *Great Northern Railway Co.* v. *Commissioner* (8 B.T.A., 225, acquiescence, C.B. VII-2, 16), to the *Baltimore & Ohio Railroad Co.* v. *Commissioner* (30 B.T.A., 194, acquiescence, C.B. XIII-2, 2), the Board reached a similar conclusion with respect to contributions to railroad companies for construction of side and spur tracks or for other construction work.

This office is of the opinion, in the light of the decisions cited, that the transfer in question did not result in taxable income to the grantee.

The remaining question is whether such transfer is subject to the gift tax imposed by the Revenue Act of 1932, as amended. That Act provides in part as follows:

SEC. 503. *Transfer for less than adequate and full consideration.*

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this title, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

Regulations 79 (1936 edition), relating to gift tax, provide in part as follows:

Art. 8. *Transfers for a consideration in money or money's worth.*—Transfers reached by the statute are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration in money or money's worth to the extent that the value of the property transferred by the donor exceeds the value of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. * * *

The facts in the present case justify the conclusion that such transfer was "made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent)." Therefore, in accordance with article 8 of Regulations 79 (1936 edition), supra, the transfer must "be considered as [having been] made for an adequate and full consideration in money or money's worth." It follows that the transfer is not subject to the Federal gift tax imposed by the Revenue Act of 1932, as amended.

HERMAN OLIPHANT,
General Counsel for the Department of the Treasury.

NEW YORK STOCK CORPORATION LAW

Section 58 of the Stock Corporation Law of the State of New York, as amended in 1938 and 1939 c. 59 of the Consolidated Laws of New York:

> No stock corporation shall declare or pay any dividend which shall impair its capital, nor while its capital is impaired, nor shall any such corporation declare or pay any dividend or make any distribution of assets to any of its stockholders, whether upon reduction of the number or par value of its shares or of its capital, unless the value of its assets remaining after the payment of such dividend, or after such distribution of assets, as the case may be, shall be at least equal to the aggregate amount of its debts and liabilities, including capital.

LIBRARY
SUPREME COURT, U.S.

Office-Supreme Court, U. S.
FILED
MAR 30 1950
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE PETITIONER IN OPPOSITION TO MOTION TO POSTPONE ARGUMENT, FILED IN DOCKET No. 682

CHARLES B. McINNIS,
ERNEST M. CALLOMON,
Mayflower Office Building,
Washington 6, D. C.,
Attorneys for Petitioner.

Of Counsel:
ROBERTS & McINNIS,
Mayflower Office Building,
Washington 6, D. C.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE PETITIONER IN OPPOSITION TO MOTION TO POSTPONE ARGUMENT FILED IN DOCKET No. 682

In No. 682 in this Court, in which the Commissioner of Internal Revenue has petitioned for a writ of certiorari to the United States Court of Appeals for the Third Circuit, the respondent, The McKay Products Corporation, anticipating the grant of certiorari, has filed a motion to postpone the argument in the case of *Brown Shoe Company, Inc.* v. *Commissioner of Internal Revenue*, which is set for

argument during the week of April 3, 1950, so that the two cases may be argued and considered together. The Brown Shoe Company, Inc., by Charles B. McInnis and Ernest M. Callomon, its attorneys, respectfully moves that the motion of the McKay Products Corporation be denied.

Reason for Opposing the Motion

1. The petition of the Brown Shoe Company, Inc., for a writ of certiorari was granted on January 9, 1950. The petitioner, Brown Shoe Company, Inc., has filed its brief in that case, has received a typewritten copy of the respondent's brief, and its counsel are presently considering filing a reply brief before the time the case is set for argument. Petitioner is ready to argue the case on the date now set by this Court. A postponement of the case would be very inconvenient.

2. Two of the issues involved in No. 445 (*Brown Shoe Company, Inc.* v. *Commissioner of Internal Revenue*) are substantially identical with the issues involved in No. 682 (*Commissioner of Internal Revenue* v. *McKay Products Corporation*). There are additional issues in No. 445, which are not involved in No. 682.

3. The moving party, The McKay Products Corporation, states (No. 2 of its reasons supporting its motion) that the reason for granting the writ of certiorari in No. 682 (*Commissioner of Internal Revenue* v. *McKay Products Corporation*) is to permit a consideration of both cases together. This is incorrect, because the reason for petitioning for, and probably also for granting, the writ in that case is that the conflict existing between the Third and Eighth Circuits be resolved.

4. The moving party, The McKay Products Corporation, has not indicated that the issues involved would not be fairly presented to this Court in No. 445 (*Brown Shoe Com-*

pany, Inc., v. *Commissioner of Internal Revenue*), or that the Brown Shoe Company, Inc., the petitioner in No. 445, has failed to argue the issues fully in its brief which it has filed and with which counsel for the moving party are familiar. The Commissioner of Internal Revenue, who is a party to both proceedings, can be expected to make a complete presentation of the issues.

5. There is no reason why the argument in the pending case should be postponed. Since in No. 682 the writ has not yet been granted and, if granted, briefs will be filed, such postponement would mean that the case of *Brown Shoe Company, Inc.* v. *Commissioner of Internal Revenue*, No. 445 in this Court, would have to be carried over into the next term. Such a delay would be most inconvenient to the petitioner, the Brown Shoe Company, Inc., and to petitioner's counsel who have made all of their plans in anticipation that the case will be argued during the week of April 3, 1950.

Conclusion

It is respectfully requested that the motion of The McKay Products Corporation, in No. 682 in this Court, to postpone argument in No. 445 (*Brown Shoe Company, Inc.*, v. *Commissioner of Internal Revenue*) be denied.

Respectfully submitted,

CHARLES B. McINNIS,
ERNEST M. CALLOMON,
Mayflower Office Building,
Washington 6, D. C.,
Attorneys for Brown Shoe Company, Inc.

Of Counsel:
ROBERTS & McINNIS,
Mayflower Office Building,
Washington 6, D. C.

LIBRARY
SUPREME COURT, U.S.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

CHARLES B. McINNIS,
ERNEST M. CALLOMON,
Mayflower Office Building,
Washington 6, D. C.,
Attorneys for Petitioner.

Of Counsel:
ROBERTS & McINNIS,
Mayflower Office Building,
Washington 6, D. C.

INDEX

	Page
Statement	1
I. The Invested Capital Issues	3
1. The Contribution to Capital Argument	3
2. The Earnings and Profits Argument	10
II. The Depreciation Issues	13
Conclusion	18

Cases Cited

Commissioner v. *F. J. Young Corporation*, 103 F. 2d 137	11
Commissioner v. *South Texas Lumber Co.*, 333 U. S. 496	9, 10
Commissioner v. *Wheeler*, 324 U. S. 542	11
Detroit Edison Co. v. *Commissioner*, 319 U. S. 98,	11, 13, 14, 15, 16, 17
Edwards v. *Cuba Railroad Co.*, 268 U. S. 628	8, 16
Edwards v. *Douglas*, 269 U. S. 204	12
Helvering v. *Canfield*, 291 U. S. 163	12
Old Colony Railroad Co. v. *Commissioner*, 284 U. S. 552	6
Texas & Pacific Railway Co. v. *United States*, 286 U. S. 285	8, 16
Willcutts v. *Milton Dairy Company*, 275 U. S. 215	12

Statutes Cited

Internal Revenue Code:	
Sec. 112	10
Sec. 113	3, 4, 5, 6, 8, 13, 14, 15, 16, 17
Sec. 115	11
Sec. 717	7
Sec. 718	3, 4, 5, 6, 7, 13
Sec. 719	7

Miscellaneous

House Report No. 1492, 72nd Congress, 1st Session	8
Senate Report No. 2114, Part 2, 76th Congress, 3rd Session	9
Treasury Regulation 111	5, 11

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

Respondent's brief does not argue the issues in the order in which they were argued in petitioner's original brief. Petitioner's reply brief will deal with respondent's arguments in the order in which the issues were presented in petitioner's original brief.

Statement

In his statement (Br. 3-8) the respondent says of the contracts made by the petitioner with the community groups that they varied "in some particulars" (Br. 4). This is a

marked understatement in view of the wide differences in the provisions of the various contracts pointed out in petitioner's original brief (pp. 3-5).

Respondent also states (Br. 4) that the contract usually contained a provision to the effect that the cash to be paid to taxpayer was to be 'used for the payment of suitable factory building or buildings and equipment thereof' or that payment was to be made to the taxpayer 'so that the same shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon'". As pointed out on page 5 of petitioner's original brief, only five of the contracts contained a clause to the effect that the contributed money was "to be used" and only three other contracts contained a provision to the effect that the contributed money was to be "available" for the payment of a factory building. Thus, only eight out of the total of sixteen contracts involved contained any such provision as that referred to by respondent.

Although respondent is unable to deny petitioner's statement that four of the contracts did not specify any period of time during which the new or enlarged plant would be required to operate, he contends (Br. 4, footnote 3) that it is "reasonable" to view the payments involved in those four cases "as at least entailing an obligation on the part of the taxpayer to continue the operation of the plant for the remainder of the ten-year period originally agreed to in each case." There is no basis in the record for such guessing.

Respondent states (Br. 5) that "the contracts further provided that, in the event the taxpayer failed to comply with their terms, either the cash payments were to be refunded, or the buildings were to be transferred to the communities." In order to explain away the six instances pointed out on page 4 of petitioner's original brief in which the contracts contain no obligation for any re-

payment of funds or re-transfer of property, respondent states (Br. 5, footnote 4) that these six contracts were "in connection with an addition or an extension of an existing factory." That comment proves nothing and does not establish an implied obligation to repay or re-transfer because none existed in those six contracts.

I. The Invested Capital Issues

Respondent's argument of the invested capital issues is found at pages 28 to 69, inclusive, of its brief.

1. *The Contribution to Capital Argument*

Respondent first avoids the issue by assuming that the contributions here involved are not "contributions to capital" within the meaning of Section 113(a)(8) of the Internal Revenue Code, and then reasons that such contributions are not includable in equity invested capital under Sections 718(a)(1) and (2) of the Internal Revenue Code (Br. 32). The reasoning would be true if respondent's assumed premise were correct, but it is not correct.

Respondent next argues (Br. 33-37) that equity invested capital is limited to amounts paid in by shareholders because Congress used in Sections 718(a)(1) and (2) the phrase "money paid in" and "property paid in", stating (Br. 34) that the expression "paid in" refers only to what is "put in" a business by a person making an investment. The nonstockholder who gives up all title to the money or property as a contribution to the corporation, in the manner that the contributors in the instant case did, "puts in" or "pays in" his money just as permanently and just as conclusively as does the stockholder.

The respondent contends that the term "capital" as used in Sections 718 (a)(1) and (2) refers only to the capital as defined in the corporation's charter and paid in by its stock

holders so that "there can be no 'contribution to capital' unless a deficit therein exists, that is to say, unless there is an impairment of capital" (Br. 35). He repeats later (Br. 37) that "a contribution to capital" can have a separate meaning when construed as reaching additional property paid in as a contribution to capital "where there is an impairment in capital". The respondent does not support his contention (Br. 35-37) by any authority and there is no authority to support him. Petitioner's capital was not impaired since it always had accumulated earnings and profits in excess of $971,031.01 (R. 129).

In order to explain away the continued use, in the Regulations promulgated both under Section 113(a)(8) of the Internal Revenue Code and corresponding sections of the prior Revenue Acts, and those under Section 718 of the Internal Revenue Code, of the term "contribution to capital" as representing a contribution acquired "from any person", the respondent argues (Br. 38-40) that the phrase "from any person" should be interpreted to mean from a shareholder (Br. 33, 34, 35, 45, 50, 52) or "some other person having a proprietary interest in the corporation, such as the holder of some hybrid security of a corporation which is not classifiable as stock, or perhaps even a bond holder" (Br. 39, 40). If the Regulations had intended any such limitation, they would have said so.

Thus, in order to give effect to respondent's contention, this Court is asked to interpret Sections 718(a)(1) and (2), I.R.C., as if they read as follows, the additional language required by respondent's interpretation being italicized:[1]

> "(1) MONEY PAID IN. Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital, *(which means a contribution to the corporation's capital only insofar as there is a deficit therein) made by a stockholder or by some other person having a pro-*

[1] Respondent's brief pp. 39, 40.

prietary interest in the corporation (such as the holder of some hybrid security of the corporation which is not classifiable as stock, or by a bondholder).

"(2) PROPERTY PAID IN.—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid in surplus, or as a contribution to capital (*which means a contribution to the corporation's capital only insofar as there is a deficit therein*) *made by a stockholder or by some other person having a proprietary interest in the corporation (such as the holder of some hybrid security of the corporation which is not classifiable as stock, or by a bondholder).*"[2]

The relevant portion of the Regulations promulgated under Section 718, I.R.C.,[2] would have to be interpreted as if it read as follows, the additional language required in order to give effect to respondent's interpretation being italicized:

"Section 30.718-1 DETERMINATION OF DAILY EQUITY INVESTED CAPITAL—MONEY AND PROPERTY PAID IN.—

If the property was acquired after December 31, 1920, by a corporation from a shareholder as paid in surplus or from any person as a contribution to capital (*which means a contribution to the corporation's capital only insofar as there is a deficit therein*) *made by a stockholder or by some other person having a proprietary interest in the corporation (such as the holder of some hybrid security of the corporation which is not classifiable as stock, or by a bondholder)*, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made. (See Section 113(a)(8).)"

The same limitation would have to be read into Section 29.113(a)(8)-1 of Treasury Regulations 111 and the corresponding section of the prior regulations promulgated under Section 113(a)(8) of the Internal Revenue Code and cor-

[2] The text of the regulation is set out on page 78 of petitioner's original brief.

responding sections of the prior revenue acts, in order to give effect to the respondent's contention.

The following observation from page 57 of respondent's brief is peculiarly applicable here:

> "* * * The simple answer is that Congress did not say so. If Congress had intended to so provide, it would have been a simple matter for it to have said so."

If the Treasury Department had intended any such limitation in the Regulations promulgated under Sections 718 and 113(a)(8) of the Code, it certainly would have said so. No reasonable person could be expected to construe the phrase "or from any person as a contribution to capital" to contain the involved limitations argued for by respondent.

This Court has repeatedly stated that Congress must be presumed to have used words in a statute in the "usual, ordinary and everyday meaning of the term", *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 561. Although relying upon the decision of this Court in *Old Colony R. Co.* v. *Commissioner*, *supra*, in another connection [3], the respondent apparently does not agree with the rules of statutory construction summarized by this Court in its decision in that case as follows (p. 560):

> "* * * The rule which should be applied is established by many decisions. 'The legislature must be presumed to use words in their known and ordinary signification.' *Levy* v. *M'Cartee*, 6 Pet. 102, 110, 8 L. ed. 334, 337. 'The popular or received import of words furnishes the general rule for the interpretation of public laws.' *Maillard* v. *Lawrence*, 16 How. 251, 261, 14 L. ed. 925, 930. And see *United States* v. *Buffalo Natural Gas Fuel Co.*, 172 U. S. 339, 341, 43 L. ed. 469, 470, 19 S. Ct. 200; *United States* v. *First Nat. Bank*, 234 U. S. 245, 258, 58 L. ed. 1298, 1303, 34 S. Ct. 846;

[3] Respondent's brief p. 48.

Caminetti v. *United States*, 242 U. S. 470, 485, 61 L. ed. 442, 452, L. R. A. 1917F, 502, 37 S. Ct. 192, Ann. Cas. 1917B, 1168. As was said in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 370, 69 L. ed. 660, 662, 45 S. Ct. 274, "the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and ingenuity and study of an acute and powerful intellect would discover.' This rule is applied to taxing acts; *De Ganay* v. *Lederer*, 250 U. S. 376, 381, 63 L. ed. 1042, 1044, 39 S. Ct. 524.'"

In defining invested capital under the World War I excess profits tax, Congress intended to limit invested capital to money or property paid in by the stockholders plus earnings accumulated from past operations and specifically said so.[4] Congress intended to exclude borrowed capital under the earlier law and specifically said so.[5]

In defining the composition of invested capital under the World War II excess profits tax, Congress intended to permit the inclusion of borrowed capital and specifically said so (Sections 717 and 719, I. R. C.).

In defining equity invested capital under the World War II excess profits tax, Congress provided for the inclusion of money or property paid in for stock, or as paid-in surplus, or as a contribution to capital (Sections 718 (a) (1) and (2), I. R. C.). This Court is asked to interpret that definition as limiting a contribution to capital to one made "exclusively" (Br. 45) by stockholders, or at least by holders of some hybrid security or holders of bonds. Respondent's interpretation is contrary to the principles of statutory construction announced by this Court many times. It imputes to Congress and to the Treasury Department (which is entrusted with promulgation of Regulations) a shocking laxity in drafting the highly important invested

[4] Petitioner's original brief, p. 17-19.

[5] Petitioner's original brief p. 18, footnote 14.

capital provisions of the Internal Revenue Code and the Regulations promulgated thereunder. The simple fact is that Congress did not intend to limit invested capital to money or property paid in by stockholders, or by holders of some hybrid security, or by holders of bonds. When it used the term "contribution to capital" as a component of equity invested capital, it obviously intended to include something more than paid-in surplus, and obviously used that term in the sense in which it was then interpreted in the Commissioner's Regulations promulgated under Section 113 (a) (8) of the Internal Revenue Code; namely, as a contribution from any person to the capital of the corporation.[6]

The Treasury Department has at no time in any of its Regulations or rulings, so far as we have been able to find, limited the term "contribution to capital" to stockholders or to an amount necessary to make good an impairment of capital. The respondent's argument on this point is clearly contrary to the decisions of this Court in *Edwards* v. *Cuba R. Co.*, 268 U. S. 628, as explained in *Texas & Pacific R. Co.* v. *United States*, 286 U. S. 285, which characterizes the payments involved in *Edwards* v. *Cuba R. Co.* as "contributions to the capital of the railroads." The contributions made to the Cuba Railroad Company, which are closely similar to those involved in the instant case, were not paid in order to make good an impairment of capital, and the Government of Cuba was not a stockholder and did not become one as a result of the contribution.

---

[6] The fact that Congress intended that the term "contribution to capital" should include something more than paid-in surplus is indicated by the following excerpt from the Conference Report (H.R. Report No. 1492, 72nd Congress, 1st Session, page 13) on the Revenue Act of 1932: "Amendment No. 44: This amendment provides that where property was acquired by a corporation as a contribution to capital, *as well as where it was acquired as paid-in surplus*, the basis shall be the same as the basis in the hands of the transferor; and the House recedes." (Emphasis supplied.)

In arguing (Br. 47-49) that the inclusion of borrowed capital as a component of invested capital under the World War II excess profits tax was not a real departure from the concept of invested capital under the earlier law, the respondent points to the fact that the law requires an adjustment for interest on the borrowed money. It is true that such an adjustment in the interest deduction is required, but that does not prove that the addition of borrowed capital was not a substantial change from the concept of invested capital under the earlier law. Moreover, borrowed capital is includable in invested capital, irrespective of whether interest was paid or payable.

Respondent argues (Br. 49-56) that the legislative history of the invested capital provisions of the World War II excess profits tax shows that the concept of invested capital under the later law is the same as under the earlier law, citing in support of that argument certain statements contained in Senator La Follette's Minority Report (S. Rep. No. 2114, Part 2, 76th Congress, 3rd Session). Senator La Follette had proposed an excess profits tax which was different from that adopted by Congress and which was designed to be a permanent feature of our tax system. His draft contained substantially the same concept of invested capital as existed under the earlier law but modified in a number of particulars. However, his views were rejected and Congress adopted a different concept. His entire Minority Report is an attempt to demonstrate that his proposal was superior to the concept proposed by the majority and later adopted by Congress. The statements in his Minority Report shed no light on the issue here involved.

Respondent's argument (Br. 56-60) that equity invested capital does not include all "working capital", is answered by the observation of this Court in *Commissioner* v. *South Texas Lumber Company*, 333 U. S. 496, 497, that with minor exceptions the excess profits tax is imposed on

"all annual net income in excess of 8% of a corporation's *working capital*, including its accumulated profits." (Emphasis supplied.)

Respondent argues (Br. 60-61) that the underlying purpose of the excess profits tax law supports his contention that the contributions of $971,031.01 should be excluded from invested capital. The exact contrary is true. The underlying purpose of the law supports petitioner's position. That purpose, as stated by this Court, was "to tax abnormally high profits due to large governmental expenditures about to be made from appropriations for national defense". *Commissioner* v. *South Texas Lumber Co.*, *supra*. The contributions here involved have no relation whatever to the large governmental expenditures made in connection with the defense and war program. The income earned by petitioner with those contributions was part of petitioner's normal income. If the contributions are excluded from petitioner's invested capital, that income will be taxed at the excess profits tax rates as excessive income, though it clearly does not fall in that category.

2. *The Earnings and Profits Argument*

In arguing that the contributions here involved are not includable in petitioner's equity invested capital as "accumulated earnings and profits" (Br. 61-69), respondent confuses the deferment or nonrecognition of income which will eventually be taxable with the receipt of nontaxable items. The difference in the effect on "earnings and profits" between the receipt of items which are not taxable at any time, and deferred installment profits or unearned premium on insurance, or nonrecognized gains and losses within the purview of Section 112 of the Internal Revenue Code, was pointed out at page 43 of petitioner's original brief. That difference clearly appears in the Commissioner's Regula-

tions promulgated under Section 115 of the Internal Revenue Code.[7]

Respondent argues (Br. 63-65) that the adoption of Section 115 (l) is a clear expression of a congressional intent to provide that gain will not affect earnings and profits until it has been recognized in the computation of income. However, he fails to note that Section 115 (l) relates specifically to nonrecognized gain which will be subjected to tax eventually, and was adopted in order to give legislative sanction to that portion of the Regulations which had been overruled in *Commissioner* v. *F. J. Young Corporation, et al.*, 103 F. 2d 137 (affg. 35 B. T. A. 860), as pointed out on pages 48 and 49 of petitioner's original brief. This Court held in *Commissioner* v. *Wheeler*, 324 U. S. 542, that the Commissioner's Regulations were valid and that the legislation was in effect unnecessary. Nothing in Section 115 (l) provides that an item which is not taxable at any time may not be included in "earnings and profits". Any such provision would have overruled the Commissioner's Regulations which have long provided that items not taxable to the corporation when received, nevertheless constitute part of the corporation's "earnings and profits" if the receipt of such items increases the corporation's surplus (Section 29.115-3, Regulations 111, and corresponding provisions of prior Regulations).[8]

This Court observed in *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, 103, that the payments there involved, although not taxed when received, increased that corporation's surplus, stating:

> . . . The receipts have gone, so far as here involved, to add to the Company's surplus. They have

[7] Set out on pp. 76 to 78 of petitioner's original brief.

[8] The relevant portion of this Regulation appears at pages 76 to 78 of petitioner's original brief.

not been taxed as income, presumably because it has been thought to be precluded by this Court's decisions in Edwards v. Cuba R. Co., 268 U. S. 628 * * *".

In an effort to avoid the conclusion, which logically follows from his argument that the amounts here involved do not constitute part of petitioner's "earnings and profits" —namely, that a distribution of the surplus created by the receipt of the contributions would be tax free in the hands of petitioner's stockholders—respondent contends (Br. 67-69) that an amount equivalent to the value of the properties will be recouped in earnings and profits through the natural process of use of the properties without a depreciation allowance, or, in the event of sale, by the taxation of the profit with no basis for computing gain or loss. This argument confuses assets with surplus. The surplus is the excess of the value of the assets on the asset side of petitioner's balance sheet over its liabilities, including capital stock. *Helvering* v. *Canfield*, 291 U. S. 163, 166, *Willcutts* v. *Milton Dairy Company*, 275 U. S. 215, 218, *Edwards* v. *Douglas*, 269 U. S. 204, 214. Thus, when the money and property other than money were received, petitioner's surplus was immediately increased by a corresponding amount. The surplus thus created became available for distribution as a dividend. The dividend need, of course, not be distributed in the form in which the asset was received. Neither the exact dollars received from the communities nor the property other than money received from the communities have to be distributed as such. The composition of "earnings and profits" for the purpose of determining the taxable status of a dividend is not dependent upon the ability to segregate and identify the various items entering into "earnings and profits".

If, instead of using the two buildings until their useful life had been exhausted or instead of selling them, petitioner should distribute them in kind to its stockholders, after it has fulfilled the conditions of the contracts under which they

were received, and if petitioner had at that time no other earnings and profits accumulated subsequent to March 1, 1913, would the distribution in kind relieve petitioner's stockholders of tax on the distribution? Respondent fails to answer this question but it may be safely assumed that he would contend that such distribution represented a distribution of petitioner's "earnings and profits". If that be true for the purpose of determining the taxable status of the distribution in the hands of petitioner's stockholders, then it is also true for the purpose of determining petitioner's "accumulated earnings and profits" under Section 718(a)(4) of the Internal Revenue Code.

II. The Depreciation Issues

Respondent's argument of the depreciation issues is found at pages 13 to 28, inclusive, of his brief.

Respondent's entire argument on the depreciation issues is grounded upon this Court's decision in *Detroit Edison Company* v. *Commissioner, supra.* In substance, respondent's contention is that the decision of this Court in the *Detroit Edison Company* case has abrogated the provisions of Sections 113(a)(2) and 113(a)(8)(B). Although his brief is silent on the point, the same conclusion would logically apply to the provisions of Section 113(a)(5), which gives to the devisee of property transmitted at death a new basis other than cost to the taxpayer. Respondent's position on the effect of this Court's decision in the *Detroit Edison Company* case is summarized in the following excerpt from page 17 of his brief:

> "But, in the taxable years here involved, the taxpayer (no replacement costs having yet been paid by it—at least insofar as material here) is entitled only to depreciation deductions limited to its own cost of its property under Section 113(a) * * *. This is clearly the result required under Section 113(a), as interpreted by this Court in the *Detroit Edison* case."

If this Court did intend to hold in the *Detroit Edison Company* case that a taxpayer is entitled to depreciation deductions only if the property in question has cost to him, then respondent's argument would be correct. However, petitioner believes that this Court did not intend to make any such sweeping decision in the *Detroit Edison Company* case, and that the facts here involved are so different from those in that case as to make that case inapplicable here.

Congress has clearly evidenced an intention to permit taxpayers a deduction for depreciation on property having no cost to them, in certain instances. Section 113(a) of the Internal Revenue Code and corresponding sections of prior revenue acts provide that "the basis of property shall be the cost of such property *except that* (emphasis supplied)," and then list a number of exceptions to the general rule that the basis shall be cost. Among those exceptions are Section 113(a) (2) which deals with property received as a gift, 113(a) (5), which deals with property transmitted at death, and 113(a) (8) (B), which deals with property received as paid-in surplus, or as a contribution to capital. The taxpayer, who receives property as a gift, has no cost. Nevertheless, Congress has provided that such taxpayer is entitled to depreciation on the basis of the property in the hands of the donor, or the last preceding owner by whom it was not acquired by gift. Section 113(a) (2), I.R.C.[3]

The taxpayer, who receives property transmitted by death, has no cost. Nevertheless, Congress has provided that such taxpayer may deduct depreciation on the property in question on the basis of the fair market value of such property at the time of such acquisition. Section 113(a)(5) I.R.C.

[3] This rule applies to property received as a gift after December 31, 1920. Fair market value of the property at the date of the gift is the basis for property received as a gift prior to January 1, 1921 (Sec. 113(a)(4), I.R.C.).

The corporate taxpayer, which receives property as paid-in surplus or as a contribution to capital, has no cost. Nevertheless, Congress has provided that such taxpayer may deduct depreciation on such property on its basis in the hands of the transferor. Section 113(a)(8)(B), I.R.C.

Thus, it is apparent that Congress did not intend and has not provided that a taxpayer's depreciation is limited to its cost of the property in all instances. The real question is whether the contributions here involved constitute gifts within the meaning of Section 113(a)(2), or contributions to capital within the meaning of Section 113(a)(8)(B).

Respondent answers petitioner's argument that the contributions here involved constitute gifts or contributions to capital within the meaning of Sections 113(a)(2) or (8) of the Code by stating that the taxpayer in the *Detroit Edison Company* case likewise contended that the contributions there involved constituted gifts or contributions to capital and that such contention was rejected by this Court (Br. 18-19). However, that does not prove that the contributions here involved were not gifts or contributions to capital. In the *Detroit Edison Company* case the recipient was in the business of selling electricity and required the contributions from its prospective customers, as a condition to providing them with its service. The customer, who made the payment and secured the line extension, had a continuing interest in the extension and had a right to demand continued service from the utility company for the indefinite future.

This Court held that the payments were to the customer the price of the service, and that the customer did not intend to give the utility company anything, or to make any contribution to its capital. That is an indisputable fact and not a mere gratuitous observation by this Court, as respondent contends (Br. 19). The only way in which the customer could obtain the service offered by the utility company was

to make the payment required by the company as a condition to the extension of its line to his home or place of business. Had he been able to obtain the service without making the payment, he would not have made it.

In an effort to spell out a comparison of the contributions in the instant case with the payment exacted by the utility company in the *Detroit Edison Company* case, respondent argues (Br. 21-22) that the contributors in the instant case must have had some reason for making the contributions and that such reason must have been an expected benefit to the particular community. Consequently, he argues, since there was some reason for making the contribution, it cannot qualify as a gift or a contribution to capital within the meaning of Section 113(a)(2) or (8). If that test were valid, there could never be a gift or contribution to capital. Every donor of a gift has some reason for making it. The contributor to a community chest or to the endowment fund of a school expects to have the community benefit from his gift, and where his contribution is made in consideration of similar gifts by others, receives sufficient consideration to sustain a contract. Nevertheless, such a contribution is regarded as a gift in the tax sense.

In Edwards v. *Cuba R. Co.*, *supra*, the contributions there involved were made in exchange for very definite consideration, including among other things a reduction in mail pay, but this Court held, as indicated in *Texas & Pacific Railway Co.* v. *United States*, *supra*, that such contributions represented gifts or contributions to the capital of the railroad.[10]

The contributions here involved were just as much gifts or contributions to the capital of the petitioner as are the contributions made by the average contributor to a community chest or school endowment fund. Here the contributors had no business dealings or contractual relations

[10] This point is discussed at pages 27 and 28 of petitioner's original brief.

with petitioner other than that which resulted from the making of the contributions. They were not seeking any service from petitioner, or employment by petitioner, nor right to purchase any goods from petitioner. The contributions were made in a complete "arm's length" transaction with no compulsion whatever on the part of the contributor. The contracts between petitioner and the contributing groups are replete with expressions of goodwill on the part of the contributing groups clearly indicating that they intended to convey to petitioner an economic benefit or gain, and that petitioner should enjoy the fruits of such gain. Nothing more could be asked of the maker of a gift or of a contribution to capital.

Respondent argues (Br. 17) that if any doubt remains as to whether the contributions here involved constitute gifts or contributions to capital under Section 113(a)(2) or (8), the matter is completely dispelled by the provisions contained in Section 113(b)(1)(A), which require that the contributions received by the petitioner with respect to its buildings and equipment be charged against the cost thereof as "receipts * * *" properly chargeable to capital account." This begs the entire question. As observed by this Court in the *Detroit Edison Company* case (p. 101), the expenditures, receipts or losses are chargeable to capital account "except in the case of certain gifts, transfers as paid in surplus, or contributions to capital". If the contributions here involved constitute gifts or contributions to capital, the adjustments required under Section 113(b)(1)(A) are not applicable to the contributions as such, but the fact that Section 113(b)(1)(A) requires such adjustments in certain instances does not prove that the contributions in question are not gifts or contributions to capital within the meaning of Section 113(a)(2) or (8). It should also be noted that the basis of the two buildings under Section 113(b) has been covered by stipulation in the instant case (R. 32).

The respondent's argument (Br. 26-28) against petitioner's alternative contention that if the cash received from the communities is to be allocated against the cost of the new or enlarged factories in the particular communities, then part of the contribution should be allocated to the cost of training new employees and the cost of providing opening inventories, is directly contrary to his earlier argument that the establishment and operation of the factories was to the communities the price of the contributions.[11] Assuming *arguendo* that the consideration for the contribution was the establishment and operation of the factories in the particular communities, then it would seem self-evident that the contribution should be allocated against all of the consideration and not merely part of it. The training of new employees and the providing of opening inventories were essential to the operation of the factories.

Conclusion

The decision of the Court of Appeals for the Eighth Circuit should be reversed.

Respectfully submitted,

CHARLES B. MCINNIS,
ERNEST M. CALLOMON,
Mayflour Office Building,
Washington 6, D. C.,
Attorneys for petitioner.

Of Counsel:
ROBERTS & MCINNIS,
Mayflower Office Building,
Washington 6, D. C.

[11] See his brief p. 3 where he states that the contributions were made to the petitioner for constructing or enlarging a factory "and operating it in the particular community."

LIBRARY
SUPREME COURT, U.S.

Office - Supreme Court, U. S.
FILED
DEC 15 1949
CHARLES ELMORE CROPLEY
CLERK

No. 445

In the Supreme Court of the United States

OCTOBER TERM, 1949.

BROWN SEED COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	3
Argument	6
Conclusion	12
Appendix	13

CITATIONS

Cases:

A.C.F. Gasoline Co. v. *Commissioner*, 6 B.T.A. 1337	10
Commissioner v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225	7
Commissioner v. *South Texas Co.*, 333 U. S. 496	10, 11, 12
Commissioner v. *Wheeler*, 324 U. S. 542	11
Detroit Edison Co. v. *Commissioner*, 319 U. S. 98	7-8
Downey, C. L., Co. v. *Commissioner*, 10 T. C. 837 affirmed, 172 F. 2d 810	7
Edwards v. *Cuba Railroad*, 268 U. S. 628	11
Holton, Frank, & Co. v. *Commissioner*, 10 B.T.A. 1317	10
Labelle Iron Works v. *United States*, 256 U. S. 377	10
Liberty Mirror Works v. *Commissioner*, 3 T. C. 1018	9
McKay Products Corp. v. *Commissioner*, 9 T. C. 1082	7, 8, 9

Statutes:

Internal Revenue Code:

Sec. 23 (26 U.S.C. 1946 ed., Sec. 23)	19
Sec. 113 (26 U.S.C. 1946 ed., Sec. 113)	8, 13, 20
Sec. 114 (26 U.S.C. 1946 ed., Sec. 114)	20
Sec. 115 (26 U.S.C. 1946 ed., Sec. 115)	14
Sec. 718 (26 U.S.C. 1946 ed., Sec. 718)	8, 9, 11, 16
Revenue Act of 1917, c. 63, 40 Stat. 300, Sec. 207	10

Miscellaneous:

Report of the Subcommittee of the Committee on Ways and Means of the House of Representatives, 76th Cong., 3d Sess., made August 8, 1940, on the proposed excess profits tax and special amortization, p. 3	10
Treasury Regulations 103, Sec. 19.113(a)(8)-1	18
Treasury Regulations 109, Sec. 30.718-1	9, 17
Treasury Regulations 111, Sec. 29.113(a)(8)-1	18
Treasury Regulations 112, Sec. 33.718-1	18

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 23-26) is reported in 10 T. C. 291. The opinion of the Court of Appeals for the Eighth Circuit (R. 149-160) is reported in 175 F. 2d 305.

JURISDICTION

The judgment of the Court of Appeals was entered on June 17, 1949 (R. 161). The petition for rehearing of the petitioner, Brown Shoe Company, Inc., filed on August 1, 1949 (R. 163-166), was

denied on August 8, 1949 (R. 167). The petition for a writ of certiorari was filed on November 5, 1949. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

QUESTIONS PRESENTED

1. Whether the court below properly held that the petitioner was not entitled to include in its equity invested capital for the taxable years 1942 and 1943 the amount of $971,031.01, representing the total amount of cash and property other than cash contributed to it by certain community groups, either as "a contribution to capital" under Section 718(a)(1) and (2) of the Internal Revenue Code, or as "accumulated earnings and profits as of the beginning of such taxable year" under Section 718(a)(4) thereof.

2. Whether the court below properly held that the petitioner was not entitled to a deduction in each of the taxable years on account of depreciation under Section 23(l) and (n), Section 113(a) and (b) and Section 114(a) of the Code on shoe factory buildings and equipment to the extent that they were contributed to the petitioner or acquired through the use of cash contributions, made to it in prior years by various communities in which such factories and equipment were situated.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 13-21.

STATEMENT

The facts were stipulated (R. 27-34), and were found by the Tax Court (R. 23-25). So far as material here, they may be summarized as follows, record references being to the stipulation:

The petitioner is a New York corporation, having its principal place of business in St. Louis, Missouri. It filed its returns for the fiscal years ended October 31, 1942, and 1943, with the Collector for the First District of Missouri. (R. 27.)

At all times material here, the petitioner was engaged in the manufacture and sale at wholesale of shoes and conducted its manufacturing operations in Missouri, Illinois, Indiana and Tennessee (R. 27-28).

In the years 1914 to 1939, inclusive, the citizens of various communities in these states contributed an aggregate amount of $885,559.45 in cash and $85,471.56 in property to the petitioner for the purpose of constructing and operating shoe factories there (R. 28-29).

(a) *The Invested Capital Issue*

The Commissioner disallowed the petitioner's claim that the total amount of $971,031.01 of money and property contributed by the various community groups was includible in its equity invested capital (R. 13). Accordingly, the Commissioner reduced the petitioner's equity invested capital for each of the fiscal years ended October 31, 1942, and 1943, by the amount of $971,031.01, representing

the contributed cash and the value of the contributed buildings (R. 31).

The Tax Court sustained the Commissioner's determination in this respect (R. 24-25). On the petitioner's appeal, the Court of Appeals affirmed the Tax Court's decision on this issue (R. 160).

(b) *The Depreciation Issue*

The cash received was deposited by the petitioner in its general bank account and debited to cash on the debit side of its ledger (R. 30). The cash received by it from particular groups was not earmarked for, or held intact and applied against the, cost of the factory, machinery, equipment, or other items applicable to the plant acquired or constructed in the particular community. In every instance, the cash received by the petitioner from community groups, as above stated, was less than the amount expended by it for the acquisition or construction of the factory building and the machinery of such factory. (R. 31.)[1]

In determining the amount of depreciation to be disallowed for the fiscal years ending 1941, 1942, and 1943, attributable to the assets acquired with contributed cash, the Commissioner first deter-

[1] Exhibit 18-R (R. 113), attached to the stipulation, is typical of the journal entries from petitioner's books reflecting the receipt by it of cash from the citizens of Sullivan, Illinois, together with entries reflecting the construction of the petitioner's new plant there (R. 31). The petitioner received $100,000 in cash from the citizens of Sullivan (Ex. 11-K (R. 29, 85-93)) and spent more than $50,000 in addition to this amount in the construction of the new factory there (R. 113-114).

mined the total cost to the petitioner of the factory building, the land (in instances where land was purchased by it), and the machinery, and then allocated the cash contribution received by the petitioner from citizens or particular communities to the cost of the buildings, land (in instances where land was acquired), and machinery in the ratio of the total cost of each of such items to the aggregate cost of all of them for the particular factory.[2] (R. 31-32).

The Commissioner disallowed deductions on account of depreciation claimed by the petitioner to the extent of $22,472.60 on contributed property, i.e., in amount of $85,471.56, and on property acquired with contributed funds, i.e., in the amount of $885,559.45, above referred to (R. 13).

The Tax Court reversed the Commissioner's de-

[2] Attached to the stipulation, marked Exhibits 1-A to 16-P, inclusive (R. 35-109), are the contracts which the taxpayer entered into with citizen groups of each community (R. 28). Thus Exhibits 1-A and 2-B (R. 35-39) are the contracts with the citizens of Charleston, Illinois; Exhibits 3-C and 4-D (R. 41-53), the contract with the citizens of Mattoon, Illinois; Exhibit 5-E (R. 53-63), the contract with the citizens of Union City, Tennessee; Exhibits 6-F and 7-G (R. 65-69), the contract with the citizens of Salem, Illinois; Exhibit 8-H (R. 71-73), the contract with the City of Litchfield, Illinois; Exhibit 9-I (R. 75-77), the contract with the citizens of Vincennes, Indiana; Exhibit 10-J (R. 79-83), the contract with the citizens of Moberly, Missouri; Exhibit 11-K (R. 85-93), the contract with the citizens of Sullivan, Illinois; Exhibits 12-L and 13-M (R. 95-99), the contract with the citizens of Pittsfield, Illinois; Exhibit 14-N (R. 101-103), the contract with the citizens of Caruthersville, Missouri; Exhibit 15-O (R. 105-107), the contract with the citizens of Charleston, Missouri, and Exhibit 16-P (R. 108-109), the contract with the citizens of Murphysboro, Illinois.

termination only in so far as he had disallowed the deductions for depreciation in respect of buildings and machinery purchased by the petitioner with such contributed cash in the amount of $885,559.45, as stated. The reason assigned by the Tax Court therefor is that the cash received by the petitioner was deposited in its general checking account and "was not earmarked for or held intact and applied against the cost of the factory, machinery, equipment or other items applicable to the plant acquired or constructed in the particular community" (R. 25), and that it therefore paid for the buildings and machinery out of its own unrestricted funds. Accordingly, the Tax Court concluded that those buildings and machinery had a cost to the petitioner, as shown on its books and records, and that it was entitled to depreciation thereon (R. 26). On the Commissioner's appeal, however, the Court of Appeals reversed the decision of the Tax Court on this issue (R. 160).

The Tax Court, however, affirmed the Commissioner's determination that the petitioner was not entitled to depreciation on the property (other than cash) which had been contributed to it of a value of $85,471.56 (R. 25); and, on the petitioner's appeal, the Court of Appeals affirmed the decision of the Tax Court on this issue (R. 160).

ARGUMENT

1. The court below was correct in holding that the petitioner is not entitled to a deduction on ac-

count of depreciation in each of the taxable years 1942 and 1943 on the buildings which were contributed to it or on buildings and equipment acquired with cash contributed to it for that purpose. The decision is in accord with principles announced by this Court and applied in other cases by the lower courts. No conflict among the circuits is alleged, and, we submit, none exists. See *Detroit Edison Co. v. Commissioner*, 319 U. S. 98; *Commissioner v. Arundel-Brooks Concrete Corp.* 152 F. 2d 225 (C.A. 4th); *C. L. Downey Co. v. Commissioner*, 10 T. C. 837, affirmed, 172 F. 2d 810 (C.A. 8th); *McKay Products Corp. v. Commissioner*, 9 T. C. 1082, 1091-1095, pending on petition for review in the Court of Appeals for the Third Circuit.

In the *Detroit Edison Co.* case, *supra*, the taxpayer contended that the payments received by it from prospective customers upon applications for construction of line extensions constituted "contributions to capital" within the meaning of Section 113(a)(8)(B) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, or "gifts" within the meaning of Section 113(a)(2) of that Act, and hence that its basis should be the same as it would be in the hands of the transferor. Reliance was also placed by the taxpayer in that case upon Article 113(a)(8)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, which provided that in respect of property acquired by a corporation after De-

cember 31, 1920, from a shareholder as "paid-in surplus, or from any person as a contribution to capital," the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. Those contentions were rejected by this Court which said: "The statutory provision that the 'basis of property shall be the cost of such property' (§ 113(a)) normally means * * * cost to the taxpayer." 319 U. S. at 102. The Tax Court in the *McKay Products Corp.* case, *supra*, similarly rejected the contention made there that the buildings received by the taxpayer constituted a gift under Section 113 (a)(2) of the Internal Revenue Code. See 9 T. C. 1082, 1094-1095.

The petitioner's contention in the present case (Pet. 21), that the buildings transferred to it and the payments made to it for the construction and equipping of factories were "gifts" or "contributions to capital" within the meaning of Section 113(a)(2) and Section 113(a)(8)(B) of the Internal Revenue Code (Appendix, *infra*, p. 13), is accordingly contrary to settled principles.

2. The court below was likewise correct in holding that petitioner, in the computation of its excess profits tax liability, was not entitled to include in its equity invested capital as a "contribution to capital" under Section 718(a)(1) and (2) of the Code (Appendix, *infra*, pp. 16-17), the amount of

the cash and the value of the buildings contributed to it.

In Section 30.718-1 of Treasury Regulations 109 (Appendix, *infra*, p. 17), it is provided that for the purpose of determining equity invested capital, the amount of any property paid in is the unadjusted basis to the taxpayer for determining loss upon a sale or exchange under the law applicable to the taxable year for which the invested capital is being computed. This regulation conforms to the intent of the statute which provides, for example, in Section 718(a)(2) of the Code that "Such property [property paid in] shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange."

Since, as we have seen under point 1 above, the petitioner may not include in its basis for depreciation, which is the same as for gain or loss, an investment in property which it has not made, it similarly is precluded by the regulations and by the statute from including in equity invested capital an investment in property which it has not made. This is also the conclusion in *McKay Products Corp.* v. *Commissioner*, *supra*, 9 T. C. at p. 1096. See also *Liberty Mirror Works* v. *Commissioner*, 3 T. C. 1018.

This conclusion is further fortified by the legislative history of the excess profits tax provisions here in question which, we submit, makes it clear that only capital *risked* by a corporation is includi-

ble in its equity invested capital under Section 718(a)(1) and (2), as a basis for determining its normal earnings not subject to the excess profits tax. See the Report of the Subcommittee of the Committee on Ways and Means made August 8, 1940, on the proposed excess profits tax and special amortization, 76th Congress, 3d Sess., p. 3.

In cases involving the invested capital provisions of Section 207 of the Revenue Act of 1917, c. 63, 40 Stat. 300, it was also held that invested capital was confined to money or money's worth actually paid out in acquiring an interest in a business with a view to obtaining income or profits from the conduct of the business, and therefore, the cost of property donated to a corporation by nonstockholders could not become a part of invested capital. *Frank Holton & Co.* v. *Commissioner*, 10 B. T. A., 1317; *A. C. F. Gasoline Co.* v. *Commissioner*, 6 B. T. A. 1337. And in *LaBelle Iron Works* v. *United States*, 256 U. S. 377, 387-388, this Court pointed out that the dominant purpose of Congress was to place the peculiar burden of the tax under the earlier law upon the income of trades and businesses exceeding that which was deemed a normal reasonable return upon the capital *actually embarked* by the corporation in the business. The experience under the 1917 and 1918 laws was undoubtedly used by Congress as a guide in framing the 1940 excess profits tax law. See *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 501.

3. The petitioner's alternative and inconsistent contention (Pet. 16-19) that, in any event, the buildings transferred to it and payments made to it are includible in equity invested capital under Section 718(a)(4) of the Code (Appendix, *infra*, p. 17) as "accumulated earnings and profits" was also correctly rejected below.

The petitioner does not contend that upon the receipt of such buildings and payments it realized taxable income which was recognized for tax purposes, nor did it in fact report such receipts as taxable income, presumably in reliance upon *Edwards v. Cuba Railroad*, 268 U. S. 628.

We contend that to recognize the values here in question as affecting earnings and profits would no more harmonize with the taxless character of the transaction than would the realized but unrecognized gains in *Commissioner v. Wheeler*, 324 U. S. 542, or the unrecognized gains on installment sales in *Commissioner v. South Texas Co.*, 333 U. S. 496. As held by this Court in the *Wheeler* case, the policy of the revenue laws requires the use of the same basis in determining gains and losses which are to be brought into "earnings and profits" as that used in determining the gains and losses which are to be brought into the income account for the corporation's income tax. Here, as we have seen under point 1 above, the basis for determining gain or loss and for depreciation on the investments in the buildings which the petitioner has not made,

is zero, and hence that is the basis for determining the amounts which may be included in "earnings and profits". Only at the time and to the extent that the petitioner realizes income from these investments which is recognized for income tax purposes may the "earnings and profits" account be increased. *Commissioner* v. *South Texas Co.*, *supra*. The court below properly applied these principles to the present case.

CONCLUSION

The decision below correctly applies principles which have been announced by this Court. There is no conflict among the circuits. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
LEE A. JACKSON,
CARLTON FOX,
Special Assistants to the Attorney General.

DECEMBER, 1949.

APPENDIX

STATUTE AND REGULATIONS INVOLVED IN THE EQUITY INVESTED CAPITAL ISSUE

Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—* * *

* * * * *

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities); or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U. S. C. 1946 ed., Sec. 113.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b). *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

* * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1939, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be con-

sidered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115(f) of the Revenue Act of 1934, 48 Stat. 712, or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

* * * * *

(l) [As added by Sec. 501 (a), Second Revenue Act of 1940, c. 757, 54 Stat. 974] *Effect on Earnings and Profits of Gain or Loss and of Receipt of Tax-Free Distributions.*—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

(1) for the purpose of the computation of earnings and profits of the corporation, shall be determined, except as provided in paragraph (a), by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(2) for the purpose of the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. * * *

* * * * *

(26 U. S. C., 1946 ed., Sec. 115.)

SEC. 718 [As added by Sec. 201. Second Revenue Act of 1940, *supra*]. EQUITY INVESTED CAPITAL.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money Paid In.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) *Property Paid In.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal

to its basis (unadjusted) for determining loss upon sale or exchange.

* * * * *

(4) *Earnings and Profits at Beginning of Year.*—The accumulated earnings and profits as of the beginning of such taxable year;

* * * * *

(26 U. S. C. 1946 ed., Sec. 718.)

Treasury Regulations 109, promulgated under the Internal Revenue Code:

SEC. 30.718-1. *Determination of daily equity invested capital—Money and property paid in.*—The equity invested capital for any day is determined as of the beginning of such day. The basis or starting point is found in the amount of money and property previously paid in for stock, or as paid-in surplus, or as a contribution to capital. For the purpose of determining equity invested capital, the amount of any property paid in is the unadjusted basis to the taxpayer for determining loss upon a sale or exchange under the law applicable to the taxable year for which the invested capital is being computed. * * *

* * * * *

If the property was acquired after December 31, 1920, by a corporation from a shareholder as paid-in surplus or from any person as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made. * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.113(a)(8)-1. *Property Acquired by a Corporation After December 31, 1920.*—The acquisition of property by a corporation after December 31, 1917, by the issuance of its stock or securities may not fall within the provisions of section 113(a) (7), because of the fact that the property was not acquired in connection with a reorganization. If, however, the acquisition of such property occurred after December 31, 1920, and falls within the provisions of section 113(a) (8), the limitations therein imposed upon the basis of such property are applicable.

In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, or from any person as a contribution to capital, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift, the basis thereof shall be determined under section 113(a) (2).

Section 19.113(a)(8)-1 of Treasury Regulations 103 is substantially the same as the above-quoted Section 29.113(a)(8)-1 of Treasury Regulations 111.

Treasury Regulations 112, promulgated under the Internal Revenue Code:

SEC. 35.718-1. *Determination of Daily Equity Invested Capital—Money and Property Paid In.*—

* * *

If the property was acquired after December 31, 1920, by a corporation from a shareholder as paid-in surplus or from any person as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made. (See section 113(a) (8).)- If so acquired prior to January 1, 1921, the basis is the fair market value of the property at the time it was paid in. Where the basis is the transferor's basis, those adjustments shall be made to such basis with respect to the period before the property was paid in as are proper under section 115(l) for determining earnings and profits. Thus, if A paid into a corporation in 1930 as paid-in surplus certain improved real estate purchased by him in 1920 for $20,000, with respect to which depreciation was allowed for the period held by him in amounts aggregating $6,000 (the full amount allowable), A's basis of $20,000 shall be reduced by $6,000 for the purpose of computing the invested capital of the corporation.

STATUTE INVOLVED IN THE DEPRECIATION ISSUE

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) [As amended by Sec. 121(*c*), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and

tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business

* * *

* * * * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property;

* * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * * *

(26 U. S. C. 1946 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b)

for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

(26 U. S. C. 1946 ed., Sec. 114.)

☆ U. S. GOVERNMENT PRINTING OFFICE, 1949. 888882 981

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

On December 16, 1949, the Court of Appeals for the Third Circuit handed down its opinion reversing the decision of the Tax Court in *The McKay Products Corp.* v. *Commissioner,* 9 T. C. 1082, referred to in respondent's brief in opposition herein. That opinion is printed as an appendix hereto.

In view of the conflict which has thus arisen between the Third and Eighth Circuits, the respond-

ent does not now oppose the granting of a writ of certiorari in the present case.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

DECEMBER, 1949.

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 9804

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE McKAY PRODUCTS CORPORATION, RESPONDENT

No. 9808

THE McKAY PRODUCTS CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

ON PETITIONS FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Argued November 8, 1949

Before MARIS and GOODRICH, *Circuit Judges*, and CLARY, *District Judge*.

OPINION OF THE COURT—Filed December 16, 1949

By GOODRICH, *Circuit Judge*:

The controversies between the taxpayer and the Commissioner in these two appeals present three questions for our determination. Reduced to their

simplest statement, the facts out of which the controversies arise are these:

People in the community of Sayre, Pennsylvania, sought during the depression to bring industries to town for the obvious purpose of increasing local payrolls and thus to promote general prosperity. To this end, a group of citizens organized Valley Industries, Inc., a Pennsylvania non-profit corporation, and subscribed a sum of money to it. A company which is in fact the taxpayer's predecessor, but will be referred to as the taxpayer,[1] moved to town and received a plant for the conduct of its business. Here are the questions which arise from these operative facts:

1. May the cost to Valley of the plant deeded to the taxpayer[2] become part of the latter's "equity invested capital," so that it may be taken account of in estimating the taxpayer's excess profits tax for a given period?

2. May the taxpayer include the cost of this plant to Valley in its figures for depreciation in subsequent tax years?

---

[1] An agreement to move to Sayre was executed by Valley Industries and Belle Knitting Corp., and it is the tax returns of Belle Knitting Corp. which concern us here. However, Belle's tax liabilities were assumed pursuant to a consolidation by Blue Swan Mills, Inc. The McKay Products Corp., which is both petitioner and respondent here, is successor by way of consolidation to Blue Swan Mills.

[2] It was agreed that Valley would purchase and improve a then vacant factory building to be occupied by the taxpayer. The property was to be deeded to the taxpayer after it had moved to Sayre and had paid out $5,000,000 in payroll, which it was estimated would take about ten years. This payroll condition was later waived, however, and the property transferred after the taxpayer had advanced money to Valley to enable the latter to meet its obligations.

3. Some of the subscribers failed to pay. Did advances made by the taxpayer to Valley create debts which give rise to a bad debt deduction, and if a debt did exist, did it become worthless and when?

I. The Excess Profits Tax Credit

The Tax Court ruled adversely on the taxpayer's contention that the $310,000 cost of the property to Valley was includible in taxpayer's excess profits tax credit for the fiscal year ending July 31, 1942, computed according to the invested capital method pursuant to Section 718 (a) (2) of the Internal Revenue Code. It was held that there could be no contribution to capital by a non-stockholder. The Court relied upon decisions by that Court, or its predecessor, the Board of Tax Appeals, which applied the statutes applicable to excess profits tax in World War I.[3] We think this ruling was incorrect.

Here is the present statutory language. It is found in Section 718 and provides that "The equity invested capital * * * shall be the sum of * * * Property (other than money) previously paid in * * * for stock, or as paid-in surplus, or as a contribution to capital." Can there be a contribution

---

[3] War Revenue Act of 1917, § 207, 40 Stat. 306: "'invested capital' * * * means * * * (a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, *for stock or shares* in such corporation or partnership * * * [emphasis added]."

Revenue Act of 1918, § 326, 40 Stat. 1092: "the term 'invested capital' for any year means * * * (2) Actual cash value of tangible property, other than cash, bona fide *paid in for stock* or shares * * * ; (3) Paid-in or earned surplus and undivided profits * * *. [emphasis added]"

Revenue Act of 1921, § 326, 42 Stat. 274: relevant language same as 1918 Act.

to capital" by a non-stockholder? If there can, the taxpayer is right and the Commissioner wrong.

The legislative history of the more recent statute casts little light upon the problem. We find only a statement by the Assistant Secretary of the Treasury, whose department played an important role in drafting the Act, explaining the reason for the shift from "value" in the earlier Acts to "cost" in the proposed statute.[4] Possibly his statement might bear the implication that no other change was made from the earlier statutes, but there certainly is no forthright declaration to this effect. Then there is a statement by a single member of the Senate Finance Committee, made in a minority report, which may or may not be taken to mean that contributions to capital can come only from stockholders for the purposes of the tax credit.[5] It is not clear from this statement whether the Senator is speaking of the draft of the bill which was eventually passed or concerning his own suggested amendment. This is all we have.

As the taxpayer points out, we find the words which are the critical words here used elsewhere in a way contrary to that which the Commissioner urges to us. The term "contribution to capital" was found in the Internal Revenue Code[6] and in the Regulations long before it appeared in Section 718. Section 29.113 (a) (8)-1 of Regulations

[4] Joint Hearings on Excess Profits Taxation before the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate, 76th Cong., 3d Sess., p. 94 (1940).

[5] Minority Report, Second Revenue Bill of 1940, Sen. Rep. No. 2114, Part 2, 76th Cong., 3d Sess., p. 12 (1940).

[6] The term is found in the basic provisions of the Revenue Act of 1932, § 113 (a) (8), 47 Stat. 200.

111 makes it clear that a contribution to capital for the purpose of Section 113 (a) (8) may come from any person. This has been true of the Regulation going as far back as 1935.[7] This use of the term must have been known to those acquainted with the tax law. Congress could have made "contribution to capital" mean one thing in Section 718 and another in Section 113 (a) (8). But if such inconsistent meanings had been intended, we think there would appear, somewhere, some evidence to that effect. We have found none.

The taxpayer's position finds support from the Regulations referring to Section 718 itself. They provide that if property is acquired "by a corporation from a shareholder as paid-in surplus *or from any person as a contribution to capital*," then the basis shall be the same as it would be in the hands of the transferor * * * [emphasis added]."[8]

The Commissioner now suggests that the phrase "from any person" has obviously been employed in the Regulations so as to include contributions to capital by bondholders or holders of "some hybrid security," while excluding contributions from those who have no interest in the corporation. Perhaps; but why is the general language to be limited to that situation? Even if such a limitation was intended by the Regulations, its finds no basis whatever in the statute.

The fact that Congress in Subchapter E gave the invested capital credit to corporate taxpayers es-

[7] U. S. Treas. Reg. 86, Art. 113 (a) (8)-1 (1935), pertaining to the Revenue Act of 1934.

[8] U. S. Treas. Reg. 112, § 35.718-1 (1944).

tablishes legislative awareness of the principle that more earnings should normally be expected to flow from an increase in working capital. The Commissioner and the Tax Court would say that this taxpayer is entitled to no greater earnings even though working assets committed to the enterprise were increased approximately twenty-five percent by Valley's contribution. Absent specific statutory language limiting the source of capital contributions for tax credit purposes, we think the contrary conclusion is correct and so hold, even though we are thus compelled to differ with the Eighth Circuit.[9]

The Commissioner urges that "capital" as used in Section 718 means the authorized capital stock of the taxpayer corporation, and cites Commissioner v. Brown Shoe Co., 175 F. 2d 305 (8th Cir. 1949) (petition for certiorari filed November 5, 1949), to sustain the argument that there can be a contribution to capital only to the extent that there is a deficit therein. It is agreed that this decision supports the Commissioner's view. We find ourselves, with due respect, in disagreement.

We do not think that such a highly technical construction (the insistence that anything above deficit cannot be a "contribution to capital") is

[9] Mention should be made to show that it has not been overlooked, of our own decision in Carlisle Tire and Rubber Co. v. Commissioner, 168 F. 2d 816 (3d Cir. 1948). There, we felt that the Dobson rule (320 U. S. 489 [1943]) required us to leave undisturbed the determination of the Tax Court that accounting practice would not permit inclusion in equity invested capital of debts forgiven by a non-stockholder creditor. The principle which guides us now is that of Section 1141 (a) of the Internal Revenue Code, 26 U. S. C. A. § 1141 (a), and we are not constrained to approve what we think to be an incorrect interpretation of Section 718.

consistent with the whole scheme of excess profits taxation contemplated by Subchapter E of the Code. We think the problems broader. Realizing that war activity would bring swollen profits to many corporations and seeking to avoid the creation of "war millionaires," [10] Congress established a level beyond which profits were deemed excessive and therefore subject to the Subchapter E tax. To fix the basis for the application of the tax, there is in the code a provision for an "excess profits tax credit." The taxpayer is given two alternative methods of computing it. First, it may deduct from the net income, subject to the ordinary income tax, the average of earnings for a given base period. Alternatively, it may as did the taxpayer here, take as a credit an amount equal to eight percent of its invested capital. "It thus appears that by this method Congress intended, with minor exceptions not here relevant, to impose the excess profits tax on all annual net income in excess of 8% of a corporation's *working capital* * * *" [emphasis added]." Commissioner v. South Texas Lumber Co., 333 U. S. 496, 497-498 (1948).

"Working capital" in common parlance means the value of that with which the enterprise carries on its activity. How much is its stake in the game? What is the amount of money which is in the business? When we find that, we allow that amount to be used as the basis to determine how much the business may earn before becoming subject to excess profits taxes. It seems to us unimportant who makes the contribution to this amount.

---

[10] H. Rep. No. 2894, 76th Cong., 3d Sess., pp. 1-2 (1940).

II. Depreciation

The Tax Court held that the taxpayer could not take as its basis for depreciation the $292,000 which was the cost of the factory building to Valley. This is the building which Valley conveyed to the taxpayer. The Internal Revenue Code provides that the basis of property received as a gift shall be that of the donor, Int. Rev. Code § 113 (a) (2), and that in the case of a contribution to capital, the transferee's basis shall be the same as it would be in the hands of the transferor. Int. Rev. Code § 113 (a) (8).

Detroit Edison Co. v. Commissioner, 319 U. S. 98 (1943) was relied upon by the Tax Court for its conclusion. If it is in point it controls. But we think it is not our case. In the Detroit Edison case, the taxpayer charged consumers for the cost of extending electric current distribution facilities and claimed as a base for computing its depreciation the full cost of the installations. The Court held that funds so paid by consumers to the taxpayer utility were neither gifts nor contributions to capital. "It is enough to say that it overtakes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company. * * * The payments were to the customer the *price of the service.* [emphasis added]" 319 U. S. at 102-103.

We think that what is significant is that the Detroit Edison Co. was in the business of selling electric power to the very persons whose payments it sought to depreciate, and that it was Detroit Edison's policy to deliver power to outlying areas

only if the consumer bore the cost of the line extension. The matter is really summed up in the Court's statement that payments were part of the price of the service.

The Tax Court thought that the transfer of property from Valley to the taxpayer could not be treated as a "gift" because the transaction was one in which there was consideration sufficient to support a simple contract. It found that consideration in the manufacturing company's agreement to move to Sayre and conduct its operations there in return for the transfer of property to it by Valley. We agree that consideration was present. But we do not, as the Tax Court did, think that the presence of consideration precludes the treatment of the conveyance as a gift to the taxpayer.

The Tax Court took the last sentence of the Supreme Court's opinion in Helvering v. American Dental Co., 318 U. S. 322, 331 (1943) to write into its requirements for gift treatment the concept "something * * * for nothing." Overlooked was that in the American Dental Co. case the taxpayer's debt was reduced as part of a transaction out of which a new lease was written and executed. Out of that can be spelled consideration in the contract sense.

The American Dental Co. decision does not of itself dispose of the problem posed by this case, for there the Supreme Court decided only that the forgiven debt was not taxable income to the debtor. It does not necessarily follow that the asset is depreciable. But the assets received from Valley, are being used by the taxpayer in the operation of its business. They will in time wear out, and if The McKay Products Corporation is to continue in

business, the physical plant must eventually be replaced. Looking as they do toward business continuity, the Internal Revenue Code's depreciation provisions—and especially those which provide for a substituted rather than a cost basis—would seem to envision allowance of a depreciation deduction in situations like this. We think that this transfer entitles the taxpayer to its donor's basis under Section 113 (a) (2), and furthermore, for the reasons given in the discussion above of the excess profits tax problem, that the same conclusion follows under Section 113 (a) (8). In this, we differ with the Fourth [11] and Eighth [12] Circuits, but our own decision in Commissioner v. Revere Land Co., 169 F. 2d 469 (3d Cir. 1948), cert. denied 335 U. S. 853, is not to the contrary. There, the taxpayer lessee received a cash grant from the owner of the real estate and used the funds to defray construction costs of an office building. In return, it took assignment of a lease which assured eventual return of the money to the owner of the land and issued preferred stock in the amount of the advance to a third corporation. It was held that the taxpayer could include the full cost of the building in his depreciation account.

III. The Bad Debt Deduction

As to this, some additional facts should be stated. Once it had been agreed that taxpayer's predeces-

[11] Commissioner v. Arundel-Brooks Concrete Corp., 152 F. 2d 225 (4th Cir. 1945). Here the court thought its result required by the Detroit Edison decision.

[12] Commissioner v. Brown Shoe Co., 175 F. 2d 305 (8th Cir. 1949); C. L. Downey Co. v. Commissioner, 172 F. 2d 810 (8th Cir. 1949). The latter case deals with "borrowed invested capital."

sor, Belle, was to move to Sayre, Valley staged a drive to raise funds for the purchase and improvement of the then vacant factory building which was to house the new industry when it came. In addition to about $60,000 in cash, Valley obtained from 1,200 to 1,500 people pledges in the amount of $250 each. Each pledge provided that if the promisor should be employed by Belle, the latter would have the right to deduct ten percent of the promisor's wages until the full sum was paid. Valley purchased the building subject to a $100,000 purchase money mortgage. After improvements had been made, Belle moved in and began manufacturing operations.

Valley found that money was not coming in fast enough on the pledges, and in order to meet its obligations, borrowed money from Belle. In return, Valley waived the $5,000,000 payroll agreement in the contract and title to the building was forthwith transferred to Belle. Later, as a prerequisite to obtaining a Reconstruction Finance Corporation loan, Belle took an assignment of the pledges from Valley. Belle then paid the balance due on the real estate mortgage, with Valley agreeing that Belle was to be reimbursed out of the payroll deductions.

In 1939, the Administrator of the Wage and Hour Division of the United States Department of Labor successfully instituted proceedings to halt payroll deductions as authorized by the pledges, on the ground that the deductions were in violation of the Fair Labor Standards Act of 1938 insofar as the net wage was below the prescribed minimum of thirty cents an hour. Valley took no further steps to enforce the pledges, and for the fiscal year ending

July 31, 1940, took a bad debt deduction of $130,607.42 under Section 23 (k) of the Internal Revenue Code.

This deduction was contested by the Commissioner, but upheld by the Tax Court. The Commissioner in his appeal contends that the advances did not give rise to debts but were the cost of acquiring property. Further, that even if debts did exist, their worthlessness was not established.

We cannot improve upon the handling of this question by the Tax Court. It found, and its findings in this respect are supported by substantial evidence, that Valley was obligated to pay the purchase price of the property transferred to Belle, and that "it was understood by both corporations that the advancements were loans which would be repaid." 9 T. C. at 1089. We agree with the Tax Court's conclusion that at the time the advances were made, both parties had every reason to believe that the outstanding pledges would be fulfilled, thus permitting Valley to satisfy its obligations. Moreover, when the pledges were assigned to Bell, Valley expressly acknowledged a then existing indebtedness to Belle and, in addition, liability for any future payments by Belle in reduction of the mortgage.

This Court has already held that a debt is defined for federal tax purposes as "an unconditional and legally enforceable obligation for the payment of money." Autenreith v. Commissioner, 115 F. 2d 856, 858 (3d Cir. 1940); Commissioner v. Park, 113 F. 2d 352 (3d Cir. 1940). That is what we find here. It cannot be said that the advances were merely the cost of acquiring property, for Belle had at all times either a promise by Valley to convey the land

and buildings free of all encumbrances, or title. True, there was a $100,000 mortgage against the factory, but Valley was contractually obligated to satisfy it.

On the question of worthlessness, we are satisfied that a sufficient showing has been made. At any rate, there is substantial evidence to support the finding of the Tax Court on this question. The probability seems remote that the balance due on the pledges could have been collected from workers whose earnings were barely above the minimum of thirty cents an hour. "Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of the deduction." U. S. Treas. Reg. 111, § 29.23 (k)-1.

The decision of the Tax Court will be reversed and the cause remanded for proceedings not inconsistent with this opinion.

A true Copy:

Teste:

_____,

Clerk of the United States Court of Appeals for the Third Circuit.

U. S. GOVERNMENT PRINTING OFFICE 1945 46781 300

INDEX

	Page.
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	3
Summary of argument	8
Argument:	
I. The depreciation issue: The taxpayer is not entitled to deductions for depreciation during the taxable years on the "contributed" buildings or on the building and equipment acquired with "contributed" cash	13
A. The court below correctly held that the taxpayer was not entitled to the depreciation deductions	13
B. On the Commissioner's appeal, the court below correctly reversed the conclusion of the Tax Court which erroneously gave controlling effect to the fact that the cash received by the taxpayer was not "earmarked"	24
C. The taxpayer's alternative claim for allocation of some of the cash received to the alleged costs of training new employees and of providing opening inventories is without merit	26
II. The invested capital issue: The taxpayer is not entitled to include in its equity invested capital for the taxable years, either as a "contribution to capital" under Section 718 (a) (1) or (2) of the Code or as "accumulated earnings and profits" under Section 718 (a) (4) thereof, the cash and other property "contributed" to it by the communities	28
A. Preliminary	28
B. The cash and buildings received by the taxpayer are not includible in its equity invested capital as "contributions to capital" under Section 718 (a) (1) or (2)	32
(1) Since the cash and buildings are not "contributions to capital" under Section 113 (a) (8), they do not constitute "contributions to capital" under Section 718 (a) (1) or (2)	32
(2) Even upon an independent examination of Section 718 (a) (1) and (2),	

880068 - 50 — 1

Argument—Continued
II. The invested capital issue—Continued
B. The cash and buildings—Continued
(2) Even upon an independent—Con. Page
the cash and buildings received by the taxpayer do not constitute "contributions to capital" thereunder 33
(a) The plain meaning of the terms of the statute supports our position 33
(b) So far as here pertinent, the 1940 excess profits tax law worked no change in the law as settled under the First World War excess profits tax law, and the decisions thereunder support our position 40
1. The addition of the term "contribution to capital" 44
2. The addition of "borrowed capital" 47
(c) The legislative history further supports our position 49
(d) Equity invested capital does not include all "working capital" or all assets used in the business 56
(e) The underlying purpose of the law supports our position 60
C. The cash and buildings received by the taxpayer are not includible in its equity invested capital as "accumulated earnings and profits" under Section 718 (a) (4) 61
Conclusion 70
Appendix 71

CITATIONS

Cases:

A. C. F. Gasoline Co. v. *Commissioner*, 6 B. T. A. 1337 42
American Cigar Co. v. *Commissioner*, 66 F. 2d 425 42
Ayer v. *Commissioner*, 12 B. T. A. 284 68
Bazley v. *Commissioner*, 331 U. S. 737 69
Bed Rock Petroleum Co. v. *Commissioner*, 29 B. T. A. 118 43
Belt Ry. Co. v. *Commissioner*, 36 F. 2d 541, certiorari denied, 281 U. S. 742 16, 17
Bogardus v. *Commissioner*, 302 U. S. 34 22
Botchford v. *Commissioner*, 81 F. 2d 914 22

ses—Continued

	Page
Butter-Nut Baking Co. v. *Commissioner*, 3 T. C. 423	62, 66
Carlisle Tire & Rubber Co. v. *Commissioner*, decided October 6, 1947, affirmed, 168 F. 2d 816	42
Carroll-McCreary Co. v. *Commissioner*, 124 F. 2d 303	42
Chenango Textile Corp. v. *Commissioner*, 148 F. 2d 296	42
Commissioner v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225	15
Commissioner v. *Auto Strop Safety Razor Co.*, 74 F. 2d 226	42
Commissioner v. *Estate of Bedford*, 325 U. S. 283	69
Commissioner v. *F. J. Young Corp.*, 103 F. 2d 137	63
Commissioner v. *Hadley*, 75 F. 2d 485	43
Commissioner v. *Jacobson*, 336 U. S. 28	22, 24
Commissioner v. *McKay Products Corp.*, 178 F. 2d 639, pending on petition for certiarari, No. 682, this term	14, 15, 16, 19, 22, 31, 53, 56
Commissioner v. *Montague*, 126 F. 2d 948	22
Commissioner v. *Revere Land Co.*, 169 F. 2d 469, certiorari denied, 335 U. S. 853	15, 16
Commissioner v. *Rosenblum Finance Corp.*, 66 F. 2d 556, certiorari denied, 290 U. S. 692	46
Commissioner v. *South Texas Co.*, 333 U. S. 496	13, 31, 41, 60, 62, 64, 65, 66, 68
Commissioner v. *Wheeler*, 324 U. S. 542	13, 62, 64, 65, 68, 69
Cummings v. *Commissioner*, 73 F. 2d 477	68
Detroit Edison Co. v. *Commissioner*, 131 F. 2d 619	16, 18, 22
Detroit Edison Co. v. *Commissioner*, 319 U. S. 98	8, 9, 10, 11, 14, 15, 16, 17, 18, 19, 21, 26, 32, 61, 67
Downey, C. L., Co. v. *Commissioner*, 172 F. 2d 810	15
Doylestown & Eastern Motor Coach Co. v. *Commissioner*, 9 T. C. 846	42
Edwards v. *Cuba Railroad*, 268 U. S. 628	23, 65, 67, 68
Edwards v. *Douglas*, 269 U. S. 204	69
Federal Union Insurance Co. v. *Commissioner*, 5 T. C. 374	62, 66
Gibson v. *Commissioner*, 83 F. 2d 869	42
Haft v. *Commissioner*, 20 B. T. A. 431	43
Hall, George, Corp. v. *Shaughnessy*, 67 F. Supp. 746	42
Helvering v. *Alworth Trust*, 136 F. 2d 812, certiorari denied, 320 U. S. 784	63
Helvering v. *Amer. Dental Co.*, 318 U. S. 322	22
Helvering v. *Bruun*, 309 U. S. 461	24
Helvering v. *Limestone Co.*, 315 U. S. 179	40
Helvering v. *Midland Ins. Co.*, 300 U. S. 216	69
Holton, Frank, & Co. v. *Commissioner*, 10 B. T. A. 1317	42, 65
Jenkins v. *Bilgood*, 101 F. 2d 17, certiorari denied, 307 U. S. 636	43
Jones, Lewis, Inc. v. *Commissioner*, 139 F. 2d 564	15
Kistler v. *Burnet*, 58 F. 2d 687	42
LaBelle Iron Works v. *United States*, 256 U. S. 377	41

Cases—Continued

	Page
Liberty Mirror Works v. *Commissioner*, 3 T. C. 1018	40, 42, 61
McKay Products Corp. v. *Commissioner*, 9 T. C. 1082	22, 42
Murphy v. *Commissioner*, decided July 28, 1945	43
Neptune Meter Co. v. *Price*, 98 F. 2d 76	63
New York Cent. R. Co. v. *Commissioner*, 79 F. 2d 247, certiorari denied, 296 U. S. 653	16, 17
Noel v. *Parrott*, 15 F. 2d 669	22
Old Colony R. Co. v. *Commissioner*, 284 U. S. 552	48
Park's Estate, In re, 58 F. 2d 965, certiorari denied, 287 U. S. 645	43
Premier Products Co. v. *Commissioner*, 2 T. C. 445	30
Ralston Steel Car Co. v. *Commissioner*, 53 F. 2d 948	42
Reisinger v. *Commissioner*, 144 F. 2d 475	15
Roberts v. *Commissioner*, 176 F. 2d 221	22
Rosenblum Finance Corp. v. *Commissioner*, 24 B. T. A. 763	46
Schweppe v. *Commissioner*, 8 T. C. 1224, affirmed, 168 F. 2d 284	42, 68
Scoville v. *Commissioner*, 18 B. T. A. 261	43
Siegel v. *Commissioner*, 29 B. T. A. 1289	63
Tampa Electric Co. v. *Commissioner*, 12 B. T. A. 1002	42, 65
Taylor v. *McLaughlin*, 30 F. Supp. 19	43
Taylor-Wharton & Steel Co. v. *Commissioner*, 5 T. C. 768	62, 66
Tunnel R. R. v. *Commissioner*, 61 F. 2d 166, certiorari denied, 288 U. S. 604	16
United States v. *Benedict*, 338 U. S. 692	60
United States v. *Gypsum Co.*, 333 U. S. 364, rehearing denied, 333 U. S. 869	26
United States v. *Yellow Cab Co.*, 338 U. S. 338	26
Walgreen, Inc. v. *Commissioner*, decided March 30, 1948	42
Walsh Holyoke Steam B. Wks. v. *Commissioner*, 160 F. 2d 185	57, 61
Weiss v. *Wiener*, 279 U. S. 333	16
Wells Fargo Bank & Union Trust Co. v. *McLaughlin*, 78 F. 2d 934, certiorari denied, 296 U. S. 638	63
West Construction Co. v. *Commissioner*, 7 T. C. 974	60

Statutes:

Internal Revenue Code:

Sec. 13 (26 U. S. C. 1946 ed., Sec. 13)	29
Sec. 22 (26 U. S. C. 1946 ed., Sec. 22)	23, 24
Sec. 23 (26 U. S. C. 1946 ed., Sec. 23)	15, 20, 71
Sec. 113 (26 U. S. C. 1946 ed., Sec. 113)	8, 9, 11, 14, 17, 18, 19, 20, 21, 23, 24, 32, 72
Sec. 114 (26 U. S. C. 1946 ed., Sec. 114)	20, 74
Sec. 115 (26 U. S. C. 1946 ed., Sec. 115)	13, 63, 64, 74
Sec. 710 (26 U. S. C. 1946 ed., Sec. 710)	29, 77
Sec. 711 (26 U. S. C. 1946 ed., Sec. 711)	29, 47, 78
Sec. 712 (26 U. S. C. 1946 ed., Sec. 712)	29, 78
Sec. 713 (26 U. S. C. 1946 ed., Sec. 713)	29, 79

Statutes—Continued Page
Internal Revenue Code—Continued
Sec. 714 (26 U. S. C. 1946 ed., Sec. 714) 29, 79
Sec. 715 (26 U. S. C. 1946 ed., Sec. 715) 29, 79
Sec. 716 (26 U. S. C. 1946 ed., Sec. 716) 30, 80
Sec. 717 (26 U. S. C. 1946 ed., Sec. 717) 30, 80
Sec. 718 (26 U. S. C. 1946 ed., Sec. 718) 10, 10, 11, 12, 13, 28, 30, 31, 32, 33, 34, 35, 16, 38, 39, 40, 50, 60, 61, 62, 80
Sec. 719 (26 U. S. C. 1946 ed., Sec. 719) 30, 47, 60
Sec. 720 (26 U. S. C. 1946 ed., Sec. 720) 30, 59
Sec. 728 (26 U. S. C. 1946 ed., Sec. 728) 32, 63, 81
Revenue Act of 1917, c. 63, 40 Stat. 300:
Sec. 207 ..... 40, 44
Secs. 200–214 51
Revenue Act of 1918, c. 18, 40 Stat. 1057:
Sec. 326 ..... 40, 44
Secs. 300–337 51
Revenue Act of 1921, c. 136, 42 Stat. 227:
Sec. 326 ..... 40, 44
Secs. 300–337 51
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 113 45
Revenue Act of 1939, c. 247, 53 Stat. 862, Sec. 215 23
Revenue Act of 1940, c. 419, 54 Stat. 516 55
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 115 24
Revenue Act of 1945, c. 453, 59 Stat. 556, Sec. 122 29
Second Revenue Act of 1940, c. 757, 54 Stat. 974:
Sec. 201 28
Sec. 501 ..... 63, 64
Miscellaneous:
G. C. M. 16952, 1937–1 Cum. Bull. 133 ..... 22, 65, 69
G. C. M. 2951, VII–I Cum. Bull. 160 (1928) 63
H. Conference Rep. No. 1492, 72d Cong., 1st Sess. (1939–1 Cum Bull. (Part 2) 539) 46
H. Conference Rep. No. 3002, 76th Cong., 3d Sess. (1940–2 Cum. Bull. 548) 48, 58, 59
H. Rep. No. 708, 72d Cong., 1st Sess. (1939–1 Cum. Bull. (Part 2) 457) 45, 46
H. Rep. No. 2333, 77th Cong., 2d Sess. (1942–2 Cum. Bull. 372) 21
H. Rep. No. 2894, 76th Cong., 3d Sess. (1940–2 Cum. Bull. 496) 48, 58, 59, 63, 64
I. T. 3253, 1939–1 Cum. Bull. 178 63
Joint Hearings, Excess Profits Taxation, 1940, 76th Cong., 3d Sess. (August, 1940) 37, 44, 48, 49, 50, 51, 58
Report of Subcommittee on Ways and Means, House of Representatives, 76th Cong., 3d Sess., on Proposed Excess-Profits Taxation (August 8, 1940) 47, 49, 50, 51, 58, 59, 60

Miscellaneous—Continued

	Page
Senate Hearings, 76th Cong., 3d Sess.	37, 56
S. Rep. No. 665, 72d Cong., 1st Sess. (1939–1 Cum. Bull. (Part 2) 496)	46
S. Rep. No. 1631, 77th Cong., 2d Sess. (1942–2 Cum. Bull. 504)	24
S. Rep. No. 2114, 76th Cong., 3d Sess. (1940–2 Cum. Bull. 528)	48, 52, 53, 54, 55, 58, 59, 60
Treasury Regulations 45:	
Art. 813	44
Art. 836	44
Art. 837	44
Treasury Regulations 103, Art. 19.113 (a) (8)–1	82
Treasury Regulations 108, Sec. 86.8	22, 69
Treasury Regulations 109:	
Sec. 30.718–1	38, 84
Sec. 30.718–2	84
Treasury Regulations 111:	
Sec. 29.22 (a)–13	42
Sec. 29.22 (a)–16	43
Sec. 29.24–2	28, 40
Sec. 29.41–1	28
Sec. 29.41–2	28
Sec. 29.41–3	28
Sec. 29.113 (a) (8)–1	18, 38, 81
Sec. 29.115–3	68
Treasury Regulations 112:	
Sec. 35.718–1	38, 82
Sec. 35.718–2	63, 83

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 445

BROWN SHOE COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 23–26) is reported at 10 T. C. 291. The opinion of the Court of Appeals for the Eighth Circuit (R. 149–160) is reported at 175 F. 2d 305.

JURISDICTION

The judgment of the Court of Appeals was entered on June 17, 1949. (R. 161.) A petition for rehearing (R. 163–166)[1] was denied on Au-

[1] The petition was filed August 1, 1949 (R. 166), after the time for filing it had been extended to August 2, 1949, by the court below (R. 162).

gust 8, 1949 (R. 167). The petition for a writ of certiorari was filed on November 5, 1949, and was granted on January 9, 1950. (R. 168.) The jurisdiction of this Court rests upon 28 U. S. C. 1254.

QUESTIONS PRESENTED

The taxpayer received cash and property other than cash from certain community groups, in each case, for locating a new factory or enlarging an existing factory, and operating it, in the particular community. The questions presented are:

1. Whether the court below properly held that the taxpayer was not entitled, under Section 23 (l) of the Internal Revenue Code, to a deduction on account of depreciation of buildings and equipment to the extent that they were "contributed" to the taxpayer by, or acquired through the use of cash "contributions" from, the community groups.

2. Whether the court below properly held that the taxpayer was not entitled to include in its equity invested capital the cash and property other than cash received from the community groups, either as a "contribution to capital" under Section 718 (a) (1) and (2) of the Code, or as "accumulated earnings and profits as of the beginning of such taxable year" under Section 718 (a) (4) of the Code.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 71–84.

STATEMENT

The facts, developed entirely by a stipulation between the parties (R. 27–34) and exhibits attached thereto (R. 35–123), were found by the Tax Court (R. 23–25). In so far as material here, they may be summarized, along the lines they were recited in the opinion of the court below (R. 149–151), as follows:

The taxpayer, Brown Shoe Company, Inc., the petitioner herein, is a New York corporation, having its principal place of business in St. Louis, Missouri. It filed its returns for the years here involved, the fiscal years ended October 31, 1942 and 1943, with the Collector of Internal Revenue for the First District of Missouri. (R. 27.)[2]

At all times material here, the taxpayer was engaged in the manufacture and sale of shoes and conducted its manufacturing operations in a number of different plants located in small towns in the States of Missouri, Illinois, Indiana and Tennessee. (R. 27–28.)

During the years 1914 to 1939, inclusive, citizens or "community groups" of 12 different towns "contributed" an aggregate amount of $885,559.45 in cash and $85,471.56 in property to the taxpayer for constructing a factory, or enlarging an existing factory, and operating it in the particular community. In each case, except one transaction

[2] This and other record references in the statement are made directly to the stipulation, rather than to the Tax Court's opinion.

involving only $10,000 in cash (R. 28), there was a written contract between the taxpayer and the community group. The contracts varied in some particulars, but generally required the taxpayer to construct or acquire a factory, or enlarge an existing one, in the particular community, to operate it for an agreed period of time, usually 10 years,[3] to employ a certain number of employees, and to meet a minimum stipulated pay roll during the period agreed upon. (R. 28–29, 35–109; see also R. 150.) The contract usually contained a provision to the effect that the cash to be paid to the taxpayer was to be "used for the payment of suitable factory building or buildings and equipment thereof" or that payment was to be made to the taxpayer "so that the same

[3] The taxpayer (Br. 3, fn. 2) states that four contracts "did not specify any period of time." However, the record shows that the four contracts referred to are in the nature of supplementary agreements with respect to the construction of an addition to a plant already constructed in a particular community pursuant to an original contract (R. 39, 69, 71–73, 99); that in three of those four cases the original contract, which is in the record, expressly provides for operation of the plant for a 10-year period (R. 37, 67, 97); that, in the case of the fourth, the original contract is not in the record, but, from the exhibit with respect to the addition to the plant, it may be reasonably inferred that the contract with respect to the original construction of the plant specified a 10-year period of operation (R. 71–73). In the light of the record, it seems reasonable to view the payments made for additions to existing plants in these four cases as at least entailing an obligation on the part of the taxpayer to continue the operation of the plant for the remainder of the 10-year period originally agreed to in each case.

shall be available for paying for the factory buildings and the equipment thereof as the work progresses thereon." (R. 150; see also R. 35, 49, 51, 65, 87.)

The contracts further provided that, in the event the taxpayer failed to comply with their terms, either the cash payments were to be refunded (R. 81), or the buildings were to be transferred to the communities (R. 37, 53, 61, 67, 77, 91, 97, 103, 105).[4] Upon compliance with the terms of the contracts, the taxpayer was to become free to operate the factories as it desired or dispose of them, and retain the proceeds without any obligation to account to the contributing groups. (R. 151.) The cash payments received by the taxpayer from the communities were not earmarked for, or held intact and applied against the cost of, the factory, machinery, equipment, or other items applicable to the plant acquired or constructed in the particular community. (R. 31.) The cash when received was deposited by the taxpayer in its general bank account and debited to cash on the debit side of its ledger, and credited to its "Earned Surplus Account" or, in some cases, first to "Contributed Surplus" and subsequently transferred to the "Earned Surplus Account." (R. 30, 151.) The value of the buildings received was set up in a

[4] The taxpayer (Br. 4) points out that in six instances the agreement with the community contained no obligation for the refunding of cash or transferring back of property. All six instances referred to are, however, agreements in connection with an addition or an extension of an existing factory. (R. 39, 41–47, 69, 71–73, 99, 108–109).

"Building Account" on the asset side of the taxpayer's ledger and thereafter carried as an asset.[3] (R. 30.) In every instance, the cash received by the taxpayer from community groups was less than the amounts expended by it for the acquisition or construction of the factory building and the machinery of such factory. (R. 31.)

In determining the amount of depreciation to be disallowed for the taxpayer's fiscal years ended October 31, 1942, and October 31, 1943, attributable to the assets acquired with contributed cash, the Commissioner first determined the total cost to the taxpayer of the factory building, the land (in cases where land was purchased by the taxpayer), and the machinery, and then allocated the cash contribution received by the taxpayer from the particular community to the cost of the building, land (in cases where land was acquired), and machinery in the ratio of the total cost of each of such items to the aggregate cost of all of them for the particular factory. (R 31–32.) The Commissioner disallowed deductions on account of depreciation claimed by the taxpayer with respect to the contributed property

[3] The value of the buildings received was stipulated as being $20,251.93 and $65,219.63, or a total of $85,471.56 (R. 28, [illegible] – which amounts have further been stipulated as the proper "bases" for depreciation and for inclusion in invested capital, if the taxpayer is entitled thereto (R. 32). Buildings were carried into the taxpayer's surplus account when received. (R. 111.)

(of a value aggregating $85,471.56) and buildings and machinery acquired with contributed funds (aggregating $885,559.45).* (R. 31.)

The Commissioner also disallowed the taxpayer's claim that the total amount of $971,031.01 of money and property contributed by the various communities was includable in its equity invested capital, and accordingly, in the computation of the taxpayer's excess profits tax liability for the fiscal years ended 1942 and 1943, reduced the taxpayer's invested capital by the amount of $971,031.01 for each year. (R. 14–15, 18–19, 31.)

The Tax Court affirmed the Commissioner's determination that the taxpayer was not entitled to depreciation on the property (other than cash) which had been contributed to it, and also sustained the Commissioner's determination with respect to the invested capital computation. (R. 24–25.) The Tax Court, however, reversed the Commissioner's determination in so far as he had disallowed the deductions for depreciation with respect to buildings and machinery acquired with contributed cash. (R. 25–26.) It gave as its reason the fact that the cash received by the taxpayer was deposited in its general checking account and was not "earmarked," and that therefore the taxpayer paid for the buildings and machinery out of

* The actual amount of disallowance on account of depreciation was $22,472.60 with respect to the fiscal year ended 1942 (R. 12–13), and $24,307.10 for the fiscal year ended 1943 (R. 16).

its own unrestricted funds. The Tax Court concluded that those buildings and machinery had a cost to the taxpayer, as shown on its books, and that the taxpayer was entitled to depreciation thereon. (R. 26.)

On the Commissioner's appeal, the court below reversed the Tax Court's decision as to the allowance of depreciation deductions with respect to buildings and machinery purchased with contributed cash (R. 152–155); on the taxpayer's appeal, the court below affirmed the decision of the Tax Court that the taxpayer was not entitled to depreciation on the property (other than cash) contributed to it, and affirmed the Tax Court's decision on the invested capital issue (R. 155–160).

SUMMARY OF ARGUMENT

I

A. *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98, disposes of the taxpayer's claim for depreciation deductions on buildings and equipment to the extent contributed to it, or acquired with cash contributed to it, by community groups, in each case as an inducement to operate a factory, or enlarge an existing one, in the particular community.

The taxpayer seeks the deductions on the theory that the cash and buildings it received were either "gifts", within the meaning of Section 113 (a) (2) of the Internal Revenue Code, or "contribu-

tions to capital", within the meaning of Section 113 (a) (8) (B) thereof so that its depreciation base would be that of the donor or transferor. Identical contentions were rejected by this Court in *Detroit Edison,* where the taxpayer had received payments from prospective customers upon applications for construction of line extensions, the Court holding squarely that the taxpayer was limited to *its own cost* as its basis for depreciation under Section 113 (a). The taxpayer's outlay, i. e., *its net investment* in the property, was held to be "the measure" of its "recoupment" through depreciation. From the fundamental principle that generally an investment in the property is a prerequisite to the allowance of depreciation deductions, it follows naturally that a taxpayer should not be allowed to recover an investment in property he has not made, where, as here, none of the exceptions to the general statutory rule applies. Therefore, the taxpayer here is not entitled to depreciation deductions on its buildings and equipment to the extent it has not borne their cost. If any doubt remained, it is dispelled by Section 113 (b) (1) (A), which would require that what was received by the taxpayer with respect to its buildings and equipment be charged against their cost as "receipts * * * properly chargeable to capital account". *Detroit Edison,* which is applicable and controlling here, requires affirmance on the depreciation issue.

B. The court below was correct in reversing, on the Commissioner's appeal, the Tax Court's erroneous conclusion that, in cases where the taxpayer had received cash, it was entitled to depreciation on the full cost of buildings and equipment because the cash was not "earmarked". That fact was not given any legal significance in the *Detroit Edison* case, and it was properly deemed not controlling by the court below.

C. There is no merit to the taxpayer's alternative claim that it is entitled to allocate some of the cash received to the costs of training new employees and of providing opening inventories. That was not the purpose for which the cash was paid over.

II

A. Affirmance is also required on the invested capital issue, because the taxpayer is not entitled, in the computation of its excess profits tax liability, to include in its "equity invested capital", either as a "contribution to capital" under Section 718 (a) (1) and (2) of the Code, or as "accumulated earnings and profits" at the beginning of each taxable year under Section 718 (a) (4), the cash and buildings it received from the communities.

B. As to the claim that the cash and buildings received are includible in equity invested capital as "contributions to capital" under Section 718 (a) (1) and (2), a complete answer is found in

the *Detroit Edison* decision since "contribution to capital" has the same meaning in Section 113 (a) (8) as it has in Section 718 (a) (1) and (2).

An independent analysis of Section 718 (a) (1) and (2) establishes that the cash and buildings received by the taxpayer are not includible in equity invested capital as "contributions to capital". In the computation, under the "invested capital" method, of the excess profits upon which the tax is imposed, Section 718 of the excess profits tax law of 1940, as properly interpreted, permits the inclusion in "equity invested capital" of the amounts "paid in" or invested by the shareholders in the business, in payment for their stock, as "paid-in surplus", or as a "contribution to capital", plus the amount of prior years' profits that have been allowed to remain invested in the business. The resultant amount, plus certain "borrowed capital", constitutes the base upon which the allowable non-taxed margin of profit is computed. Aside from the limited inclusion of "borrowed" capital, the law contemplates the allowance of a credit based exclusively upon what is *invested* in the business by the stockholders, consisting of what they have "paid in" and the prior profits they have left in the business. Only "money" or "property" originating from stockholders is includible in "equity invested capital" under Section 718 (a) (1) or (2) as "contribu-

tions to capital". The cash and buildings received by the taxpayer from the communities in question do not qualify for inclusion thereunder as "contributions to capital".

This conclusion is required by the plain terms of the statute and by its aim and purpose, particularly in the light of legislative history and principles established by applicable decisions—particularly decisions on the very same question under the First World War excess profits tax law, which, insofar as material here, was not different from the 1940 law. What is includible in equity invested capital under Section 718 of the 1940 law is limited to the items therein specified: It does not include all "working capital" or all assets used in the business. Under the correct concept of "capital", as the term is used in Section 718 (a) (1) and (2), capital consists only of a corporation's capital as such (i. e., the capital which is defined in its charter and paid in by its stockholders), and therefore there can be no "contribution to capital" unless there is a deficit therein, because contributions above that are necessarily "paid-in surplus". The two terms "paid-in surplus" and "contributions to capital" are merely correlative, "contributions to capital" having been developed and added, in the course of our income taxation experience, as the necessary complement of "paid-in surplus". Both terms necessarily relate exclusively to amounts paid in by shareholders, or possibly, as the Regulations

must have intended, by other persons having a proprietary interest in the corporation, such as the holder of some hybrid security, or even a bondholder.

C. The fundamental principle enacted into law in Section 115 (l) of the Code, and upheld in *Commissioner* v. *South Texas Co.*, 333 U. S. 496, and *Commissioner* v. *Wheeler*, 324 U. S. 542, disposes of the taxpayer's remaining contention, that the cash and buildings are includible in its "equity invested capital" under Section 718 (a) (4) as "accumulated earnings and profits" as of the beginning of each taxable year. Under that principle, gains which have not been recognized in the computation of income are not reflected in earnings and profits. Here, the buildings and cash, assumed not to constitute taxable income upon their receipt, are not includible in "accumulated earnings and profits".

ARGUMENT

I

The depreciation issue: The taxpayer is not entitled to deductions for depreciation during the taxable years on the "contributed" buildings or on the building and equipment acquired with "contributed" cash

A. The court below correctly held that the taxpayer was not entitled to the depreciation deductions

The taxpayer in this case sought, and the Commissioner disallowed, depreciation deductions on buildings and equipment to the extent that they had been "contributed" to taxpayer or acquired by

taxpayer with "contributed" cash. The court below held that the taxpayer was not entitled to the claimed deductions. (R. 152–155, 160.) Previously, in *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, where a taxpayer had similarly claimed depreciation deductions on the portion of the cost of its properties which equalled the amounts its customers had paid towards their construction, this Court had held squarely that the "cost" of property under Section 113 (a) of the Revenue Act of 1936, c. 690, 49 Stat. 1648 (identical with Section 113 (a) of the Internal Revenue Code (Appendix, *infra*, pp. 72–73) means "cost to the taxpayer" (p. 102). This Court stated that "the taxpayer's outlay is the measure of his recoupment through depreciation accruals" (p. 102). It recognized there that a taxpayer must not be "permitted to recoup through untaxed depreciation accruals" (p. 103) an investment in property it has not made. It is submitted that the decision of the court below on the depreciation issue in this case properly follows the rule laid down by this Court in the *Detroit Edison* case, and is unquestionably correct—and that the decision on the similar depreciation question in *Commissioner* v. *McKay Products Corp.*, 178 F. 2d 639 (C. A. 3d), is clearly wrong.

It was because of the conflict caused by the *McKay Products* decision that the opposition to the application for the writ in this case was withdrawn by the Government. A petition for a writ has since been filed by the Government in the *McKay Products* case (No. 682, this Term).

Until the contrary decision of the Third Circuit in the *McKay Products* case, it had been uniformly held, in keeping with this Court's decision in the *Detroit Edison* case, that the basis for depreciation deductions on property in similar situations is the cost thereof to the taxpayer or, in other words, the taxpayer's "net investment" in the property, just as the court below held. See *Commissioner* v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225 (C. A. 4th); *C. L. Downey Co.* v. *Commissioner*, 172 F. 2d 810 (C. A. 8th); see also *Lewis Jones, Inc.* v. *Commissioner*, 139 F. 2d 564 (C. A. 3d); *Reisinger* v. *Commissioner*, 144 F. 2d 475 (C. A. 2d).[8]

This Court had long ago laid down the principle that an investment in the property sought to be depreciated is a prerequisite to the allowance of a deduction for depreciation under a depreciation provision identical with that now contained in Section 23 (l) of the Code (Ap-

[8] While the Court of Appeals for the Third Circuit, in its opinion in the *McKay Products* case (pp. 643–644), regarded its decision in that case as not contrary to its earlier decision in *Commissioner* v. *Revere Land Co.*, 169 F. 2d 469, certiorari denied, 335 U. S. 853, we believe that it was clearly contrary to it. In the *Revere Land* case, the Third Circuit had held that the owner of the building, the Grant Company, was entitled to depreciation upon the entire cost of the building, even though it had received some money from the ground lessor, the Revere Company, because the Grant Company had "paid" for the money with the preferred stock it had issued (169 F. 2d at p. 482). It was because of that fact that the court in the *Revere* case distinguished that case from the *Detroit Edison* and *Arundel-Brooks* cases (pp. 482–483).

pendix, *infra*, p. 71). *Weiss* v. *Wiener*, 279 U. S. 333. That principle has been generally followed by lower courts. See *New York Cent. R. Co.* v. *Commissioner*, 79 F. 2d 247 (C. A. 2d), certiorari denied, 296 U. S. 653; *Tunnel R. R.* v. *Commissioner*, 61 F. 2d 166 (C. A. 8th), certiorari denied, 288 U. S. 604; *Belt Ry. Co.* v. *Commissioner*, 36 F. 2d 541 (C. A. D. C.), certiorari denied, 281 U. S. 742; see further *Detroit Edison Co.* v. *Commissioner*, 131 F. 2d 619, 622 (C. A. 6th), affirmed, 319 U. S. 98, and *Commissioner* v. *Revere Land Co.*, 169 F. 2d 469, certiorari denied, 335 U. S. 853.

The fact that the taxpayer's buildings and equipment, either contributed to it or acquired with contributed cash, are being used up in the business and "will in time wear out" and "must eventually be replaced" (cf. *Commissioner* v. *McKay Products Corp.*, 178 F. 2d 639, 643 (C. A. 3d)), does not entitle the taxpayer to a deduction for depreciation with respect thereto to the extent that the taxpayer has not borne their cost. The taxpayer, in so far as the buildings and equipment contributed to it or acquired with contributed cash are concerned, has made no capital investment on which it is presently suffering a loss. The mere fact that it will have to replace the properties does not suffice to give it a depreciable interest in the properties, in so far as contributed to it or acquired with contributed cash. *Weiss* v. *Wiener*, 279 U. S.

333. If, as, and when the taxpayer does replace the buildings and equipment and makes its own investment therein, it will then begin to suffer a loss thereon and will at that time become entitled to depreciation deductions to the extent of its investment, i. e., to the extent of the cost of the replacements. See *New York Cent. R. Co.* v. *Commissioner*, 79 F. 2d 247, 251 (C. A. 2d), certiorari denied, 296 U. S. 653; *Belt Ry. Co.* v. *Commissioner*, 36 F. 2d 541, 542 (C. A. D. C.), certiorari denied, 281 U. S. 742. But, in the taxable years here involved, the taxpayer (no replacement costs having yet been paid by it—at least insofar as material here) is entitled only to depreciation deductions limited to its own cost of its property under Section 113 (a), namely, zero with respect to the buildings donated to it, and, with respect to the other buildings and equipment, their cost *less* the amount of the cash contributed to it. This is clearly the result required under Section 113 (a), as interpreted by this Court in the *Detroit Edison* case. And, if any doubt remained about the matter, it is completely dispelled by the provision contained in Section 113 (b) (1) (A) (Appendix, *infra*, p. 73), which would clearly require that the contributions received by the taxpayer with respect to its buildings and equipment be charged against the cost thereof as "receipts * * * properly chargeable to capital account".

See *Detroit Edison Co.* v. *Commissioner*, 319 U. S. at p. 102, and 131 F. 2d at p. 622.

The decision of this Court in the *Detroit Edison* case is dispositive of the taxpayer's claim that it is entitled to depreciation deductions with respect to the buildings and equipment acquired with contributed cash, either under Section 113 (a) (2) or (8) of the Code (Appendix, *infra*, pp. 72–73). (Br. 55–62). In the *Detroit Edison* case, the taxpayer contended that the payments received by it from prospective customers upon applications for construction of line extensions constituted "gifts" within the meaning of Section 113 (a) (2) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, or "contributions to capital" within the meaning of Section 113 (a) (8) (B) of that Act.[9] In that case, the taxpayer also relied upon Article 113 (a) (8)–1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, which provided that in the case of property acquired by a corporation after 1920 from a shareholder as "paid-in surplus, or from any person as a contribution to capital", the basis of the property in the hands of the corporation is the basis which the property would have in the hands of the transferor if the transfer had not been made.[10]

[9] These provisions are identical with the corresponding provisions of the Internal Revenue Code relied upon by the taxpayer here. (Br. 56–57.)

[10] The provision of the Regulations there relied upon is the same as the corresponding provision of Treasury Regulations 111, Section 29.113 (a) (8)–1 (Appendix, *infra*, pp. 81–82), as the taxpayer admits (Br. 24).

Those contentions were flatly rejected by this Court, which held the basis of the property to be the "cost to the taxpayer" (319 U. S. 98, 102).

There is no merit to the taxpayer's attempt (Br. 15–16, 60–62) to distinguish the *Detroit Edison* case from the present case on the ground that in that case the payments received by the company "were to the customer the price of the service" (319 U. S. 98, 103).[11] Exactly in the same sense that the payments received by the taxpayer in the *Detroit Edison* case were to the payor "the price of the service", the cash and the buildings received by the taxpayer in the instant case were to the communities (which paid or transferred them to the taxpayer) *the price* they paid to have the taxpayer operate the plant in the particular community, or enlarge an existing plant, for the period of time and under the conditions specified in the contract.

The comment that the payments "were to the customer the price of the service" was merely an observation made by this Court in *Detroit Edison* in connection with its general rejection of the contention that the payments received by the taxpayer there were either gifts or contributions to capital so as to make Section 113 (a) (2) or (8) applicable. It is true that neither there nor here were the payments received by the taxpayer in return for services rendered

[11] The Third Circuit made that erroneous distinction in the *McKay Products* case (178 F. 2d 639, 643).

or to be rendered *in the usual sense*. The payments were described as part of the "price" in an effort dramatically to distinguish them from gifts or contributions. As inducements, they were neither gifts nor contributions.

A deduction from gross income on account of depreciation of property is permitted by Section 23 (l) of the Code (Appendix, *infra*, p. 71), and Section 23 (n) (Appendix, *infra*, p. 71) provides that the "basis" for depreciation shall be as provided in Section 114. Section 114 (a) (Appendix, *infra*, p. 74) provides that the basis for depreciation shall be the "adjusted basis" provided in Section 113 (b) (Appendix, *infra*, pp. 73–74) for determining gain upon the sale of property, which in turn provides that the adjusted basis shall be the basis determined under Section 113 (a) (Appendix, *infra*, pp. 72–73) with certain adjustments set out in Section 113 (b). Amongst these adjustments is the one required to be made by Section 113 (b) (1) (A) (Appendix, *infra*, p. 73) for "expenditures, receipts, losses, or other items, properly chargeable to capital account". Section 113 (a) provides that the basis for property shall be the cost thereof, with certain exceptions, amongst which are the exceptions provided in Section 113 (a) (2), to the effect that if property was acquired by gift after 1920 its basis shall be the same as that of the donor, and in Section 113 (a) (8) (B), which is to the effect that if property was acquired as "paid-in surplus or as

a contribution to capital", the basis shall be the same as it would be in the hands of the transferor.

Consequently, the taxpayer here is not entitled to the depreciation deductions in question, because its measure for depreciation is limited to its cost, under Section 113 (a), and, as seen, *supra*, pp. 18–20, neither Section 113 (a) (2) nor Section 113 (a) (8) is applicable. Just as this Court said in the *Detroit Edison case* (319 U. S. 98, 102), it may also be said here that "it overtaxes imagination" to regard the communities which paid the cash or transferred the buildings to the taxpayer as the makers of gifts or contributions to the capital of the taxpayer. It may well be true, as the taxpayer asserts (Br. 60), that the "contributions" were made "voluntarily" and that the makers intended to transfer to the taxpayer an "economic benefit", but those elements cannot serve to transform the payments of cash or transfers of property into either gifts or contributions to capital of the taxpayer. It is obvious from the record that the transfers were not gratuitous and were not made with a donative intent, but were made with the expectation on the part of the communities of deriving benefits which would come from the taxpayer's performance of its undertaking to operate a plant in the community, or to enlarge an existing operation. The expected benefits must to the communities have seemed real and vital enough to warrant the making of the substantial payments here involved. The

benefits expected by the small communities in question must be regarded as substantial, in a very material sense—and not merely as an "intangible satisfaction", as the taxpayer suggests. (Br. 62.) The communities in question were not giving the taxpayer the buildings and cash "for nothing" (*cf. Commissioner* v. *Jacobson*, 336 U. S. 28)—as the "price" of their payments, they exacted the promise by the taxpayer to operate a plant in the community, or to enlarge an existing operation.[12] That constituted a valuable consideration, and, a valuable consideration being present, the transfers cannot possibly be regarded as "gifts". See *Detroit Edison Co.* v. *Commissioner*, 131 F. 2d 619, 622–623 (C. A. 6th); *Commissioner* v. *Montague*, 126 F. 2d 948, 951 (C. A. 6th); *Roberts* v. *Commissioner*, 176 F. 2d 221, 223 (C. A. 9th); *McKay Products Corp.* v. *Commissioner*, 9 T. C. 1082, 1092–1095, reversed, 178 F. 2d 639 (C. A. 3d). See also *Noel* v. *Parrott*, 15 F. 2d 669, 671 (C. A. 4th); *Botchford* v. *Commissioner*, 81 F. 2d 914, 916 (C. A. 9th); cf. *Bogardus* v. *Commissioner*, 302 U. S. 34, and *Helvering* v. *Amer. Dental Co.*, 318 U. S. 322.[13]

[12] See Section 86.8, Treasury Regulations 108, relating to the gift tax under the Internal Revenue Code, where it is stated that a "transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent)" will be considered as made for a full consideration, and hence not a gift.

[13] G. C. M. 16952, 1937–1 Cum. Bull. 133, relied upon by the taxpayer (Br. 27, 38), recognized that such transfers would

In varying situations, Congress has recognized that a taxpayer who has received property without paying for it and without taking it into income and paying an income tax thereon at the time of its receipt,[14] should not be allowed an annual deduction for depreciation of the property because no investment of his in the property is being used up. Where receipt free from income tax of gain or income has been permitted, Congress has at the same time required that no advantage be taken of that receipt in the "basis" for the property. This is demonstrated, for example, by amendments to the Code made by Section 215 of the Revenue Act of 1939, c. 247, 53 Stat. 862, whereby, in adding the provisions of Sections 22 (b) (9) and 113 (b) (3) to the Code, Congress "prescribed that, in order for a corporate taxpayer to exclude from its gross income under Section 22 (a) certain gains attributable to the discharge within the taxable year of the taxpayer's indebtedness evidenced by

---

not be subject to the gift tax as "gifts". The question of whether such transfers can possibly be regarded as "contributions to capital" is further discussed in the second part of this argument.

[14] The record does not show specifically that the payments here were not taxed as income when received, but the taxpayer admits they were not (Br. 38), and both the court below and the Tax Court so assumed (R. 24, 158). That assumption was obviously warranted by the showing in the record that the contributions were either taken directly into the earned surplus account, or into contributed surplus and then transferred into the earned surplus account (R. 30, 113-114). Cf. *Edwards* v. *Cuba Railroad*, 268 U. S. 628.

bonds, the taxpayer must consent to the subsequent use of those gains in reducing the basis of property held by the taxpayer during any portion of the taxable year in which such discharge occurred". *Commissioner* v. *Jacobson*, 336 U. S. 28, 46. Another illustration is contained in the amendments made by Section 115 (a) and (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, whereby Congress, by adding Section 22 (b) (11) to the Code, permitted the exclusion from the gross income of a lessor of property, upon the termination of a lease, of the income attributable to improvements made by the lessee, while at the same time, by adding Section 113 (c) to the Code, it required that the lessor's basis for the property be not increased on account of the improvements made by the lessee which are excluded from income under Section 22 (b) (11). See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 44, 69 (1942–2 Cum. Bull. 372, 408, 425–426); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 78–79 (1942–2 Cum. Bull. 504, 564–565).[15]

B. On the Commissioner's appeal, the court below correctly reversed the conclusion of the Tax Court which erroneously gave controlling effect to the fact that the cash received by the taxpayer was not "earmarked"

The court below was correct in reversing (R. 152–155), upon the Commissioner's appeal, the

[15] These amendments to the Code came after it had been held in *Helvering* v. *Bruun*, 309 U. S. 461, that improvements made by the lessee constituted income to the lessor upon forfeiture of the lease.

erroneous conclusion of the Tax Court (R. 25–26) to the effect that the taxpayer was entitled to depreciation deductions based upon the full cost, as shown on its books, of the buildings and machinery with respect to which it had received cash contributions from the communities. The Tax Court, while recognizing the principle that the basis for depreciation of property is the cost to the taxpayer in holding that the Commissioner had not erred in disallowing depreciation on the contributed buildings (R. 25), reversed the Commissioner's determination in so far as he had disallowed depreciation deductions in respect of buildings and machinery acquired with contributed cash. That conclusion of the Tax Court as to the buildings and machinery acquired with contributed cash was based upon the significance which the Tax Court erroneously accorded to the fact that the cash received by the taxpayer "was not earmarked" (R. 25) for the particular purpose for which it had been contributed, and that the taxpayer paid for the buildings and machinery out of its own unrestricted funds.

The court below reversed on this point because it felt that the Tax Court had "committed a clear mistake of law and fact". (R. 154.) The action of the court below on this point was unquestionably correct, we submit, for the reasons given by it (R. 152–155) and because proper upon the record.

This is not, as the taxpayer claims (Br. 64), a situation where the trier of the facts has decided "to weigh more heavily" for one side, "in choosing between two permissible views of the weight of the evidence." It is not a case in which "the evidence would support a conclusion either way." *United States* v. *Yellow Cab Co.*, 338 U. S. 338, 342. Cf. *United States* v. *Gypsum Co.*, 333 U. S. 364, rehearing denied, 333 U. S. 869.[16] In this case, the Tax Court arrived at an erroneous conclusion with respect to the buildings and equipment acquired with contributed cash simply because it improperly accorded controlling legal significance to the fact that the cash received by the taxpayer was deposited in its general bank account and was not "earmarked". In *Detroit Edison*, the payments there received likewise went into the taxpayer's general funds and were not "earmarked". (319 U. S. 98, 100.)

C. The taxpayer's alternative claim for allocation of some of the cash received to the alleged costs of training new employees and of providing opening inventories is without merit

Taxpayer argues (Br. 65–66), in the alternative, that if the cost of buildings and machinery is to be reduced by the amount of cash received from the communities, then the cash contributions should also be allocated in part to the al-

[16] In this case there was neither a conflict in the evidence nor in the inferences reasonably to be drawn therefrom: The case simply presented a question as to the correct legal conclusions to be drawn from the undisputed, stipulated facts.

leged cost of training new employees and of providing opening inventories, instead of being allocated only to the cost of buildings, machinery and land (when land was acquired).

In support of this alternative contention, the taxpayer asserts (Br. 65) that the costs of training new employees and of opening inventories were stipulated. While it is true that it was stipulated (R. 33) that Exhibit 20–T (R. 119) shows those costs, the stipulation itself shows that the Commissioner questioned the correctness of the allocation reflected in that exhibit, in addition to objecting to its content as immaterial and irrelevant (R. 33). But the basic fallacy of the contention lies in the fact that, while taxpayer may have found it necessary to train new employees and to supply opening inventories (R. 32–33), it did not receive the cash payments for those purposes, nor was it in any case even authorized to use the cash it received for those purposes: All of the cash was given either specifically to be "used" for the payment of buildings or additions, and equipment, or was given as consideration for, on account of, or for the construction of buildings or additions, and equipment. (R. 35–99, 105–109.) The costs of training new employees and of opening inventories, whatever their amount, cannot possibly be related to the receipts from the communities; those costs were, as stipulated (R. 32–33), currently deducted by the tax-

payer and allowed by the Commissioner in computing the taxpayer's taxable income for the respective years in which they incurred. See Treasury Regulations 111, Sections 29.24–2, 29.41–1, 29.41–2 and 29.41–3. The contention that they should now enter into the allocation is so obviously without merit, we believe, that the court below was justified in not even passing upon it expressly in its opinion. (R. 149–160.) Though again brought to its attention by the taxpayer's petition for rehearing (R. 164), the court below merely denied the petition (R. 167), correctly, we submit.

II

The invested capital issue: The taxpayer is not entitled to include in its equity invested capital for the taxable years, either as a "contribution to capital" under Section 718 (a) (1) or (2) of the Code or as "accumulated earnings and profits" under Section 718 (a) (4) thereof, the cash and other property "contributed" to it by the communities

A. Preliminary

This invested capital issue arises under Section 718 of the Internal Revenue Code (Appendix, *infra*, pp. 80–81), which section is part of the new subchapter (SUBCHAPTER E—EXCESS PROFITS TAX) which was added to the Code by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, entitled "Excess Profits Tax Act of 1940", applicable to taxable years beginning after December 31, 1939, and which was in effect repealed, as to taxable years begin-

ning after December 31, 1945, by Section 122 (a) of the Revenue Act of 1945, c. 453, 59 Stat. 556.

In that new subchapter, a tax was imposed by Section 710 (a) (Appendix, *infra*, p. 77) upon the "adjusted excess profits net income" as defined in Section 710 (b), namely, the "excess profits net income" as defined in Section 711, less the following: (1) A specific exemption of $5,000; (2) an excess profits credit computed under Section 712; and (3) an unused excess profits credit adjustment. Section 711 (Appendix, *infra*, p. 78) provides that the excess profits net income shall be the normal tax net income (as defined in Section 13 (a) (2) under Chapter 1 of the Code, relating to income tax), with certain adjustments.

Under Section 712 (a) (Appendix, *infra*, pp. 78–79) a corporation (if in existence prior to 1940) may take an excess profits credit computed either under Section 713 on the basis of average net income during the base period (the years 1936 to 1939), or under Section 714 upon the basis of invested capital, whichever results in the lesser tax.[17] By Section 714 (Appendix, *infra*, p. 79), a credit is granted equal to eight percent[18] of the taxpayer's invested capital, determined under Section 715. In Section 715 (Appendix, *infra*,

[17] The credit based on invested capital is the one taken by this taxpayer. (R. 14–16, 17–19.)

[18] This percentage was subsequently variously modified (see fn. to Section 714, Appendix, *infra*, p. 79).

p. 79) invested capital is defined as the average invested capital determined under Section 716, reduced by an amount computed under Section 720 relating to inadmissible assets. Section 716 (Appendix, *infra*, p. 80) sets up the formula for arriving at the average invested capital, namely, the aggregate of the daily invested capital divided by the number of days in the taxable year. Section 717 (Appendix, *infra*, p. 80) states that the daily invested capital shall be the equity invested capital plus borrowed invested capital determined under Section 719. Section 718 specifies what is to be included in equity invested capital and subsections (a) (1) and (2) thereof (Appendix, *infra*, pp. 80–81) provide for the inclusion in equity invested capital of money and property, respectively, previously paid "for stock, or as paid-in surplus, or as a contribution to capital", while subsection (a) (4) (Appendix, *infra*, p. 81) provides for the inclusion of "accumulated earnings and profits" as of the beginning of the taxable year.

Thus, Sections 710 to 720 deal with the determination of the excess profits net income upon which the tax is imposed, and hence may be generally regarded as the sections dealing with the "normal" provisions of the law. See *Premier Products Co.* v. *Commissioner*, 2 T. C. 445, 450. Then, under the new subchapter, after Section 720, come the sections dealing with "abnormalities" and special cases, which need not

be mentioned here. Looking at the excess profits tax law as a whole, it is apparent that the law taxes at high rates corporate profits above a certain level, computed either upon the basis of the income during a designated prior period or upon a percentage of invested capital—or, in other words, taxes "all corporate profits and gains over and above what Congress deemed to be a fair and normal return." *Commissioner v. South Texas Co.*, 333 U. S. 496, 497.

The taxpayer claims that it is entitled to include in its equity invested capital under the provisions of Section 718 (a) (1) and (2) as "contributions to capital", the amount of $971,031.01, constituting the total of the cash and buildings contributed to it by the communities (Br. 14–36), or, in the alternative, that it is entitled to include that amount in its equity invested capital under Section 718 (a) (4) as "accumulated earnings and profits", as of the beginning of each taxable year (Br. 36–55). The court below decided against the taxpayer on both contentions. (R. 155–160.)[19] It was correct in so doing.

[19] In *Commissioner* v. *McKay Products*, 178 F. 2d 639, the Court of Appeals for the Third Circuit decided, to the contrary, that property received by the taxpayer there from a community group was includible in equity invested capital as a "contribution to capital" under Section 718 (a) (2). No alternative contention that the property was also includible in equity invested capital as "accumulated earnings and profits" under Section 718 (a) (4) was made in that case, and therefore that point was not decided by the Third Circuit.

B. The cash and buildings received by the taxpayer are not includible in its equity invested capital as "contributions to capital" under Section 718 (a) (1) or (2)

(1) Since the cash and buildings are not "contributions to capital" under Section 113 (a) (8), they do not constitute "contributions to capital" under Section 718 (a) (1) or (2)

Since Section 728 of the Code (Appendix, *infra*, p. 81) provides that the terms used in the subchapter relating to the excess profits tax, of which Section 718 is a part, shall have the same meaning as when used in the chapter relating to the income tax, Chapter 1 of the Code, of which Section 113 (a) (8) is a part, the phrase "contribution to capital" has the same meaning in Section 718 (a) (1) and (2) as it has in Section 113 (a) (8).[20] Therefore, the decision of this Court in *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, to the effect that the amounts received by the taxpayer there were not "contributions to capital" within the meaning of Section 113 (a) (8), unquestionably requires the conclusion that the payments received by the taxpayer here are not "contributions to capital" within the meaning of Section 718 (a) (1) or (2).[21]

[20] This is recognized by the taxpayer. (Br. 23.)

[21] Thus, *Detroit Edison* really disposes of the entire case, except the taxpayer's further claim that the contributions received by it are includible in equity invested capital as "accumulated earnings and profits" under Section 718 (a) (4).

(2) Even upon an independent examination of Section 718 (a) (1) and (2), the cash and buildings received by the taxpayer do not constitute "contributions to capital" thereunder

(a) *The plain meaning of the terms of the statute supports our position*

Under the excess profits tax law of 1940, the credit upon the invested capital method is based upon two factors, (1) the "equity invested capital" and (2) the "borrowed invested capital". In concept, equity invested capital is representative of an ownership or proprietary interest in the business, as distinguished from borrowed capital, which represents a creditor's interest in the business.

Equity invested capital under the statute is the amount invested in the business by the shareholders, plus the amount of earnings and profits that they have allowed to remain in the business. This is the plain meaning of Section 718, which, in substance, provides for the inclusion in equity invested capital of what the shareholders have originally paid in for their stock, plus what they have paid in as surplus or as contributions to capital, and, finally, plus whatever amount of profits of the operation in prior years they have allowed to remain invested in the business—with certain adjustments not here material. The words of Section 718 (a) (1) and (2) that are crucial here are "paid in * * * as a contri-

bution to capital". What is includible in equity invested capital necessarily relates exclusively to what is *paid in*, either in the form of cash or property other than cash, *by the stockholders* of the corporation—and not what may be *contributed to* the corporation by one who is not a stockholder. The use of the words "paid in" in both subsections (1) and (2) of Section 718 (a) clearly signifies an intent to refer only to money or property coming from stockholders. The expression "paid in" has a fixed and settled meaning and is used only to refer to what is "put in" a business by a person making an investment therein. Only an investor in a corporation, i. e., one who becomes a stockholder, *pays in* money or property to a corporation. Therefore the use of the term "paid in" clearly requires the conclusion that only money or property originating from *stockholders* can be included in equity invested capital under either subsection (1) or (2) of Section 718 (a). The correctness of this view is further demonstrated by an examination of Section 718 as a whole. For after the inclusion of the amounts originally paid in by stockholders for their stock and of the amounts paid in by them as "paid-in surplus" or "contributions to capital", equity invested capital is finally arrived at by making the additions and reductions prescribed in Section 718, with the obvious purpose and effect of allowing a credit upon the total of the amount invested by the

shareholders in the business and the amount of prior profits that have been allowed to remain invested in the business.

The correct concept of "capital" in our view, which the court below found to be supported by authority (R. 159–160), is that the term "capital" as used in Section 718 (a) (1) and (2) refers only to the corporation's capital as such, namely, to its capital as defined in its charter and paid in by its stockholders, and therefore there can be no "contribution to capital" unless a deficit therein exists, that is to say, unless there is an impairment of capital. This must be so because if there is no impairment to capital, then any contribution to a corporation must necessarily be to "paid-in surplus" within the meaning of Section 718 (a) (1) and (2).

The taxpayer criticizes this view, saying that it renders the term "contribution to capital" meaningless, because, it asserts (Br. 32), "the corporate taxpayer is expressly given the benefit of the money or property paid in for stock regardless of the time paid in and is not required to reduce that capital by any subsequent impairment." The criticism is without merit.

Contrary to the taxpayer's claim, it is only the concept of "capital" we have outlined as correct which permits the term "a contribution to capital" to have a meaning and a place of its own in the statute consistent with the general statu-

tory purpose to include in "invested capital" only amounts "risked" in the business by the owners. See *infra*, pp. 41–42, 49–56. The statute, in subsections (1) and (2) of Section 718 (a) provides for the inclusion in equity invested capital of money or property "previously paid in" in three manners: (1) "paid in * * * for stock"; (2) "paid in * * * as paid-in surplus"; and (3) "paid in * * * as a contribution to capital". With respect to "money", subsection (1) merely states that it be "previously paid in", while in the case of "property", subsection (2) contains the additional parenthetical provision that it be included "regardless of the time paid in". The parenthetical clause "regardless of the time paid in" applies to all three manners of paying in "property" permitted under subsection (2) to be included in equity invested capital. The clause "regardless of the time paid in" does not have the effect, suggested by the taxpayer (Br. 32), of making all property paid in, including that which is paid in as "paid-in surplus" or as "a contribution to capital", includible as, or under the classification of, "property paid in * * * for stock". The clause "regardless of the time paid in" appears in Section 718 (a) (2) merely as a necessary complement to the provision requiring that property be included at its "unadjusted basis"[22] so as to eliminate problems with

[22] This was a distinct departure from the First World War law, which required that property be taken in at its "value"

regard to March 1, 1913, valuations. (See Hearings before the Senate Committee on Finance, 76th Cong., 3d Sess., on H. R. 10413, p. 208.)

The result is that as to "property" the corporate taxpayer is not only "given the benefit" of "property paid in for stock regardless of the time paid in" (cf. taxpayer's brief, p. 32), but it is also given the benefit of property "paid in * * * as paid-in surplus" regardless of the time paid in, and of property "paid in * * * as a contribution to capital" regardless of the time paid in. The provisions for including property "paid in * * * as paid-in surplus" and property "paid in * * * as a contribution to capital" can, contrary to the taxpayer's assertion (Br. 32), have a separate meaning of their own under the statute when construed as reaching, over and above property "paid in * * * for stock," *additional* property, for which no stock is received, paid in as a "contribution to capital" where there is an impairment in capital, and paid in as "paid-in surplus" where there is no impairment to capital. The same is true, under subsection (1) with respect to "money" paid in.

The further reason given by the taxpayer (Br. 32) as a basis for its criticism of our view as to the concept of "capital," namely, that a tax-

(see the Memorandum prepared by the Treasury Department and submitted at the Joint Hearings before the House Ways and Means Committee and the Senate Finance Committee on Excess Profits Taxation, 76th Cong., 3d Sess. (August, 1940), p. 94).

payer is "not required to reduce that capital by any subsequent impairment," in our view supports, instead of conflicting with, the correct concept of "capital," as we have outlined it. For, the fact that the taxpayer is not required, in computing "equity invested capital", to reduce the amount of capital "paid in" by a subsequent impairment demonstrates that the statute recognizes the concept of "capital" as meaning the corporation's capital as such, namely, the capital as defined by its charter and paid in by its stockholders.

The taxpayer nonetheless argues that the cash and buildings it received, though not coming from stockholders, must be treated as "contributions to capital," within the meaning of Section 718 (a) (1) and (2), because Section 35.718-1 of Treasury Regulations 112 (Appendix, *infra*, pp. 82–83) contains the words "from any person" in referring to a "contribution to capital", while it refers to "paid-in surplus" as "from a shareholder". (Br. 25–26.)[23] The position taken is that, while "paid-in surplus" may come only from a shareholder, nevertheless under the Regulations, which taxpayer claims are binding (Br. 26), a "contri-

[23] The same provision was contained in the previous Treasury Regulations 109, in Section 30.718–1. Both excess profits tax regulations in this respect follow the wording of the previously existing Treasury Regulations under the income tax law, as they still appear in Section 29.113 (a) (8)–1 of Treasury Regulations 111 (Appendix, *infra*, pp. 81–82), as taxpayer points out. (Br. 24.)

bution to capital" may come "from any person". That contention must be examined in the light of what we have stated is the correct concept of "capital" as the term is used in Section 718 (a) (1) and (2).

Thus, in the instant case, since the taxpayer at all times material had accumulated earnings and profits in excess of the amount of $971,031.01 (R. 129), the cash and buildings received by the taxpayer would in any event be "paid-in surplus" and therefore, even under the Regulations relied upon by the taxpayer, they would not be includible in equity invested capital, since they did not come from stockholders.

But, beyond this, when examined in the light of what we have stated is the correct concept of the term "capital" used in the statute, the provision of the Regulations relied upon must be viewed as a recognition of the fact that while a contribution to "paid-in surplus" would necessarily come only from a shareholder, such as by his paying an amount in excess of par for his stock, on the other hand a "contribution to capital"—which means a contribution to the corporation's capital only insofar as there is a deficit therein, *i. e.*, one designed to wipe out a capital deficit—might be made by, in addition to a shareholder, some other person having a proprietary interest in the corporation, such as the holder of some hybrid security of the corporation which is not classifiable as stock, or perhaps even a bond-

holder.[24] Hence the use of the words "from any person" in referring to a "contribution to capital" in the Regulations must be regarded as made for the purpose of including, in addition to stockholders, other persons such as the holder of the hybrid security or the bondholder—but clearly cannot be construed also as including a person who has no proprietary interest whatever in the corporation.

(b) *So far as here pertinent, the 1940 excess profits tax law worked no change in the law as settled under the First World War excess profits tax law, and the decisions thereunder support our position.*

Under the First World War excess profits tax law, in Section 207 of the Revenue Act of 1917, c. 63, 40 Stat. 300, and in Section 326 of the Revenue Acts of 1918, c. 18, 40 Stat. 1057, and 1921, c. 136, 42 Stat. 227, invested capital was defined as including cash and property paid in to the corporation substantially in the same manner, insofar as here material, as "equity invested capital" was defined in Section 718 of the Code. See *Liberty Mirror Works* v. *Commissioner*, 3 T. C. 1018, 1024. The similarity was at least

[24] See Treasury Regulations 111, Section 29.24–2, in which it is stated "Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. (See section 29.22 (a)–16.)" Cf. *Helvering* v. *Limestone Co.*, 315 U. S. 179, 184.

in general, recognized by this Court in *Commissioner* v. *South Texas Co.*, 333 U. S. 496. In passing upon invested capital under the old law this Court stated in *LaBelle Iron Works* v. *United States*, 256 U. S. 377, 387, 388:

> A scrutiny of the particular provisions of § 207 shows that it was the dominant purpose of Congress to place the peculiar burden of this tax upon the income of trades and businesses exceeding what was deemed a normally reasonable return upon the capital actually embarked. * * * When speaking of the capital of a business corporation or partnership, such as the act deals with, 'to invest' imports a laying out of money, or money's worth, either by an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in aquiring something of permanent use in the business; in either case involving a conversion of wealth from one form into another suitable for employment in the making of the hoped-for gains. See Webster's New International Dict., "invest," 8; Century Dict. "invest," 7; Standard Dict., "invest," 1.

The Court further stated (pp. 389–390) that invested capital was to be "measured according to actual contributions made for stock * * * in order to confine the capital, the income from which was to be in part exempted from the burden of this special tax, to something approximately rep-

resentative of the risks accepted by the investors in embarking their means in the enterprise." See also *Ralston Steel Car Co.* v. *Commissioner,* 53 F. 2d 948 (C. A. 6th). Under the old excess profits tax law it had been expressly held that contributions by nonshareholders were not includible in invested capital. *Frank Holton & Co.* v. *Commissioner,* 10 B. T. A. 1317; *A. C. F. Gasoline Co.* v. *Commissioner,* 6 B. T. A. 1337; *Tampa Electric Co.* v. *Commissioner,* 12 B. T. A. 1002. The same conclusion has been reached—correctly—by the Tax Court in applying Section 718 (a) (1) or (2) of the Code in *McKay Products Corp.* v. *Commissioner,* 9 T. C. 1082, and the instant case.[25]

[25] Consistently, the amount of indebtedness of a corporation which is cancelled, has been held to be not includible in its equity invested capital if cancelled by a nonstockholder. *Liberty Mirror Works* v. *Commissioner,* 3 T. C. 1018; *Carlisle Tire & Rubber Co.* v. *Commissioner,* decided October 6, 1947 (1947 P-H T. C. Memorandum Decisions, ¶ 47,269), affirmed 168 F. 2d 816 (C. A. 3d); *Doylestown & Eastern Motor Coach Co.* v. *Commissioner,* 9 T. C. 846; *Walgreen, Inc.* v. *Commissioner,* decided March 30, 1948 (1948 P-H T. C. Memorandum Decisions, ¶ 48,042); cf. *George Hall Corp.* v. *Shaughnessy,* 67 F. Supp. 748 (N. D. N. Y.). On the other hand, the gratuitous forgiveness of a debt by a stockholder has been generally treated as a contribution to capital (see Section 29.22 (a)-13 of Treasury Regulations 111; *Carroll-McCreary Co.* v. *Commissioner,* 124 F. 2d 303 (C. A. 2d); *Commissioner* v. *Auto Strop Safety Razor Co.,* 74 F. 2d 226 (C. A. 2d); *Chenango Textile Corp.* v. *Commissioner,* 148 F. 2d 296 (C. A. 2d); *American Cigar Co.* v. *Commissioner,* 166 F. 2d 425 (C. A. 2d); *Gibson* v. *Commissioner,* 83 F. 2d 869 (C. A. 3d); cf. *Schweppe* v. *Commissioner,* 8 T. C. 1224, affirmed, 168 F. 2d 284 (C. A. 9th)), as have voluntary cash payments to a cor-

The taxpayer argues that the decisions under the First World War law are inapplicable because of the differences existing between that law and the 1940 law with respect to what is included in invested capital for the purpose of determining the amount of profits deemed to be excess. (Br. 17–22.) The differences pointed to are that, in addition to what was to be included in invested capital under the first law, the second law provided for the inclusion in invested capital of "contributions to capital" and "borrowed capital". The taxpayer argues (Br. 20) that the "inclusion of (1) borrowed capital and (2) a contribution to capital in the definition of invested capital under the later Act clearly negatives" any legislative intent to confine "invested capital" to that coming from stockholders. Neither of these differences supports the taxpayer's position here.

1. *The addition of the term "contribution to*

---

poration by its shareholders (Section 29.22 (a)–16 of Treasury Regulations 111; *Jenkins* v. *Bitgood*, 101 F. 2d 17 (C. A. 2d), certiorari denied, 307 U. S. 636; *In re Park's Estate*, 58 F. 2d 965 (C. A. 2d), certiorari denied, 287 U. S. 645), and the voluntary surrender by shareholders of a portion of their stock (*Kistler* v. *Burnet*, 58 F. 2d 687 (C. A. D. C.); *Taylor* v. *McLaughlin*, 30 F. Supp. 19 (E. D. Pa.); *Murphy* v. *Commissioner*, decided July 28, 1945 (1945 P–H T. C. Memorandum Decisions, ¶ 45,259); *Scoville* v. *Commissioner*, 18 B. T. A. 261; *Haft* v. *Commissioner*, 20 B. T. A. 431; *Red Rock Petroleum Co.* v. *Commissioner*, 29 B. T. A. 118; and *Commissioner* v. *Hadley*, 75 F. 2d 485 (C. A. 2d).

capital".—In Section 207 of the Revenue Act of 1917, invested capital was defined as including the actual cash paid in for stock or shares, the actual cash value of tangible property other than cash paid in for stock or shares, and "paid in or earned surplus and undivided profits"; expressly excluded was "money or other property borrowed". The definitions of invested capital in Section 326 of the Revenue Acts of 1918 and 1921 were substantially the same as in the 1917 Act, except that the later Acts did not apply to partnerships, while the first Act applied to partnerships as well as corporations. It is true that the old law did not expressly use the term "contribution to capital" in defining invested capital. That omission may have been due to the fact that at that time the phrase "paid-in surplus" may have been thought broad enough to include both "paid-in surplus" and "contribution to capital" as the two concepts became subsequently established and were later separately used in our income tax law. See Articles 836 and 837 of Treasury Regulations 45 (1920 ed.). See also Article 813 of the same Regulations. The Treasury Department apparently regarded "contributions to capital" as having been includible in invested capital under the old law. See the Memorandum prepared by the Treasury Department and submitted at the Joint Hearings before the House Ways and Means Committee and the Senate Finance Committee on Excess Profits Taxation, 1940 (August, 1940), 76th Cong., 3d Sess., p. 94.

The addition of "contribution to capital" in specifying what is includible in equity invested capital under the 1940 Excess Profits Tax law merely reflects the later established separate meaning of that term and simply complements the inclusion of "paid-in surplus". The term "contribution to capital" first appeared in our revenue laws, as the taxpayer points out (Br. 23), in Section 113 (a) (8) of the Revenue Act of 1932, c. 209, 47 Stat. 169. That the term "contribution to capital" must be regarded merely as the necessary complement of the term "paid-in surplus"—under the correct concept of "capital" heretofore noted (*supra*, pp. 35–40)—that it simply was intended to reach contributions from stockholders which do not constitute "paid-in surplus" because of the existence of a deficit, and that both terms "paid-in surplus" and "contributions to capital" relate exclusively to *shareholders* is further demonstrated by the Committee Reports in connection with the passage of the Revenue Act of 1932. In H. Rep. No. 708, 72d Cong., 1st Sess., p. 21 (1939–1 Cum. Bull. (Part 2) 457, 471–472), the Ways and Means Committee of the House recommended the addition to the pre-existing Section 113 (a) (8) of a provision to insure the continuation of the long established position of the Treasury Department relative to the basis of property transferred to a corporation as "paid-in surplus"—it recommended adding in Section 113 (a) (8) (B) an express pro-

vision requiring the use of the transferor's basis in the case of property received as "paid-in surplus." The proposal was directly aimed at a *shareholder* situation—at a case of property transferred to a corporation by a *shareholder* as "paid-in surplus"—and it was made with the express intention of closing the avenue of avoidance which had but recently been opened by a Board of Tax Appeals decision.[26] The Senate Finance Committee, expressing the identical intention and aiming at the same case, agreed to the proposal and apparently merely to fill out or more fully carry out the purpose of the proposal, added to it a further provision requiring that property transferred to a corporation as a "contribution to capital" should also take the transferor's basis—*i. e.*, it changed the wording of the proposed provision so as to embrace specifically property transferred both as "paid-in surplus" and as "contributions to capital". S. Rep. No. 665, 72d Cong., 1st Sess., pp. 27–28 (1939–1 Cum. Bull. (Part 2) 496, 516.) The proposal, with the Senate amendment, was adopted in conference. H. Conference Rep. No. 1492, 72d Cong.,

[26] The decision referred to (H. Rep. No. 708, *supra*) was that of the Board of Tax Appeals in *Rosenbloom Finance Corp.* v. *Commissioner*, 24 B. T. A. 763, in which it was held that a corporation receiving property contributed to it by a stockholder was not limited to the transferor's basis. However, that decision was reversed on appeal. *Commissioner* v. *Rosenbloom Finance Corp.*, 66 F. 2d 556 (C. A. 3d), certiorari denied, 290 U. S. 692.

1st Sess., p. 13 (1939–1 Cum. Bull. (Part 2) 539, 542).

2. *The addition of "borrowed capital".*—The specific inclusion of borrowed capital in invested capital in the 1940 law indicates that Congress would have specifically provided for the inclusion of contributions by "nonstockholders" if that had been its purpose. While the First World War excess profits tax law excluded borrowed capital, in the 1940 law Congress provided for the inclusion in invested capital of 50 percent of borrowed capital, as defined in Section 719 of the Code. However, at the same time, Congress required by Section 711 (a) (2) (B) that an adjustment be made to income, whereby the deduction for interest is reduced by an amount equal to 50 percent of so much interest as represents interest on indebtedness which is included in borrowed capital under Section 719 (a). The reduction of the interest deduction by a percentage equal to the percentage in which borrowed capital is included in invested capital, so as to reduce the deduction for interest on indebtedness to the extent that that indebtedness goes into invested capital, was proposed in the very first Congressional report on the 1940 excess profits tax law, and thereafter adopted in all subsequent reports of Congressional committees. See Report of a Subcommittee of the Committee on Ways and Means, House of Representatives, 76th Cong., 3d Sess., p. 13, on Proposed Excess-Profits Tax-

ation (August 8, 1940); H. Rep. No. 2894, 76th Cong., 3d Sess., pp. 8, 19, 23 (1940–2 Cum. Bull. 496, 501, 510, 513); S. Rep. No. 2114, 76th Cong., 3d Sess., p. 11 (1940–2 Cum. Bull. 528, 536); and H. Conference Rep. No. 3002, 76th Cong., 3d Sess., p. 4 (1940–2 Cum. Bull. 548, 551). See also Joint Hearings, 1940, *supra*, pp. 70–74. Briefly, the effect of the provisions is that, to the extent to which an indebtedness is included in invested capital as borrowed capital under Section 719, the deduction from income of the interest thereon shall be proportionately reduced. The significance of the required adjustment to income is that, if borrowed capital is allowed to be treated as capital "invested" in the business for the purpose of arriving at the excess profits tax credit, then the interest which represents the cost of using that borrowed money (*Old Colony R. Co.*, v. *Commissioner*, 284 U. S. 552, 560), must be eliminated as a deduction—*i. e.*, if borrowed money is treated as invested in the business, then the cost of borrowing is not entitled to be deducted from income, since no interest would be paid if the money were actually invested.

Borrowed capital was included in the 1940 law for the purpose of aiding small concerns, which had to borrow money to raise additional capital, and for the purpose of encouraging expansion, for the contemplated defense program. See Joint Hearings, 1940, *supra*, pp. 70–72, 74. It was also included for the additional purpose of

eliminating difficulties experienced under the old excess profits law in cases in which "the tax became unduly high because of the exclusion of borrowed capital from invested capital" (Joint Hearings, 1940, *supra*, p. 95).[27] The addition of borrowed capital to the limited extent of 50 percent, instead of supporting the taxpayer's position, to the effect that equity invested capital under the 1940 law must not be limited to that coming from stockholders, supports the contrary view. From the limited inclusion of 50 percent of "borrowed capital" allowed, it seems reasonable to infer that Congress was willing to depart from the concept of "stockholders' capital" only to the extent of 50 percent, and only in cases where the addition to capital constituted an obligation of the business, for which the owners were incurring a risk. The "contributions" received by the taxpayer were not obligations of the business—the taxpayer had risked nothing in so far as those "contributions" were concerned.

(c) *The legislative history further supports our position*

Further analysis of the legislative history yields strong support for our position that "contribu-

[27] It was in part because of the inclusion in invested capital of borrowed capital that the provision for the special assessment was eliminated as unnecessary in the 1940 law. See Joint Hearings 1940, *supra*, p. 95; Report of Subcommittee, *supra*, pp. 8–9.

tions to capital" which are includible in equity invested capital, under Section 718 (a) (1) and (2), relate only to contributions by stockholders.

Pursuant to a resolution of Congress (Joint Hearings before the House Committee on Ways and Means and the Senate Finance Committee on Excess Profits Taxation, 76th Cong., 3d Sess. (August, 1940), pp. 68–69), the Treasury Department had presented a plan for an excess profits tax, which was based upon the invested capital method exclusively. The staff of the Joint Committee on Internal Revenue Taxation also proposed a plan, which differed from the Treasury plan mainly in allowing the average earnings in a prior period to be used as a credit in determining the excess profits (Joint Hearings, *supra*, p. 69). The subcommittee of the House Committee on Ways and Means combined the two plans, and recommended the enactment of a law providing for alternative methods of computing the excess profits to be subjected to the tax, one based upon the invested capital method and the other based upon the average earnings of a prior period. See Report of the Subcommittee of the Committee on Ways and Means, House of Representatives, 76th Cong., 3d Sess., p. 3. See also Joint Hearings, *supra*, p. 69. The combination of the two plans, after certain changes, is what was finally adopted as the Excess Profits Tax Act of 1940. The subcommittee, in its report, expressly recognized that the tax upon the in-

vested capital method "is based upon the amount of capital being risked by the taxpayer and contemplates a tax on all profits in excess of a stated percentage of return upon the taxpayer's investment". (Report of the Subcommittee, *supra*, p. 3.)

The First World War excess profits tax laws had been based upon the invested capital method exclusively.[28] When the report of the subcommittee was being considered at the Joint Hearings in 1940, the Assistant Secretary of the Treasury, during the course of his testimony at the Joint Hearings, *supra*, pp. 68–97, submitted a memorandum[29] prepared by the Treasury Department (Joint Hearings, pp. 94–95), explaining the undesirable features of the First World War excess profits tax law and pointing out how they had been eliminated in the 1940 proposal recommended by the subcommittee. An analysis thereof demonstrates conclusively that there was no change here material in the concept of what is includible in *invested* capital—which (because of the addition of "borrowed capital") was called "equity invested capital" in the 1940 law—and discloses nothing which could possibly support the

[28] Revenue Act of 1917, c. 63, 40 Stat. 300, Sections 200 to 214; Revenue Acts of 1918, c. 18, 40 Stat. 1057, and 1921, c. 136, 42 Stat. 227, Sections 300 to 337.

[29] The memorandum was entitled "Advantages of the Invested Capital Concept Contained in the Current Excess-Profits Tax Proposal Over the Invested Capital Concept Contained in the Revenue Act of 1918."

view that the 1940 law contemplated the inclusion in "equity invested capital" of anything other than what the stockholders had invested in the business, plus the prior profits left in the business."

That equity invested capital under the 1940 law consisted exclusively of the amount invested in the business by the stockholders, aside from borrowed capital, is demonstrated further by the report submitted by Senator La Follette, ranking minority member of the Senate Finance Committee, in which he stated in part as follows (S. Rep. No. 2114, Part 2, 76th Cong., 3d Sess., p. 12):

> Moreover, it must be observed that the only property which figures in the computation of invested capital for tax purposes is property received in return for corporate stock issued to acquire such property.
>
> * * * * *
>
> The invested capital method of computing excess profits thus seeks to determine as fairly as possible the actual dollars invested by the shareholders in the business and remaining at risk in the business. It is only on actual money actually risked that invested capital is based. * * * Since invested capital is based only upon what was originally paid into the business plus the earnings remaining at risk in the

[30] The two particular differences between the two laws, which the taxpayer claims exist (Br. 17–22), have been shown to be of no contrary significance here, under subpart (b) of this argument (*supra*, pp. 43–49).

> business, subsequent write-downs on the corporate books have no effect upon invested capital. * * *

The Court of Appeals for the Third Circuit in *Commissioner* v. *McKay Products Corp.*, 178 F. 2d 639, apparently referring to these statements by Senator La Follette, remarked that they "may or may not be taken to mean that contributions to capital can come only from stockholders for the purpose of the tax credit", and further stated that it is "not clear" whether the Senator is speaking of the bill which eventually was passed or of his own suggested amendment (178 F. 2d 639, 641). While the first comment may be said to be merely unjustified, the second comment by that court was clearly wrong, because the report shows beyond any doubt that the invested capital plan which Senator La Follette had proposed in his amendment was exactly the same as the invested capital method which was finally enacted into law. Senator La Follette had proposed an amendment using the invested capital method as the sole measure of excess profits (S. Rep. No. 2114, Part 2, 76th Cong., 3d Sess., p. 11), and eliminating the "average earnings method" (same report, p. 13) which, in combination with the invested capital method, had been adopted by the House. In his minority report, he attacked the bill recommended by the Senate Finance Committee for combining what he claimed were two conflicting theories of excess profits taxation, one based on

average earnings and the other based on invested capital, and pointed to several defects and complications of the "average earnings" and the combined methods, which he claimed would be eliminated if the invested capital method alone were adopted. (Same report, pp. 1–9.) Then he presented his arguments in favor of the invested capital method, together with a refutation of the arguments against it. (Same report, pp. 9–13.) In answering the charge of "complexities" made against the invested capital method, he pointed out that those stemmed from the First World War law which had permitted the value of property paid in for stock to determine invested capital, and stated that his amendment, like the Committee amendment (*i. e.*, like the bill as amended by the Finance Committee, and as finally adopted into law), uses "the tax cost of property paid in" for determining invested capital (p. 11). He further stated that (pp. 13–14):

> My amendment is patterned after the one which was adopted by the Senate 41 to 31 (but deleted in conference) during the debate on the First Revenue Act of 1940 last June. The new amendment, however, is improved in many respects to embody technical improvements contained in the invested capital method worked out by experts of the Treasury Department. As respects the method of computing invested capital, my amendment is similar in almost every detail to the method of ascertaining invested capital under the

committee amendment. The 8 percent credit allowed on such invested capital is also the same under my amendment and the committee amendment.

In comparing his previously offered amendment (*i. e.*, the one which had been adopted by the Senate during the debate on what became the Revenue Act of 1940, c. 419, 54 Stat. 516) with his new amendment (*i. e.*, the one he was reporting on in S. Rep. No. 2114, Part 2, *supra*), Senator La Follette further stated with respect to his new amendment (p. 15):

> Technical improvement of the original amendment has been made by accepting certain definitions and methods of computing invested capital, as provided in the House bill by the Treasury experts, i. e., the computation and definition of average invested capital, daily invested capital, equity invested capital, borrowed capital, etc.

From an examination of the minority report, it is clear beyond any doubt that the statements made therein with regard to the invested capital concept apply both to the amendment proposed by Senator La Follette as well as to the bill approved by the majority of the Senate Finance Committee, which finally became law. Those statements lend further support to our view that the concept of the "invested capital" method (called "invested capital" in the First World War law and "equity invested capital" in the 1940 law) is to measure the "excess profits" upon the basis (aside from

"borrowed capital") of what the shareholders paid into the corporation, plus the prior profits left in the business. See also Hearings before the Senate Finance Committee, Second Revenue Act of 1940, 76th Cong., 3d Sess. (September, 1940), pp. 197, 208.

(d) *Equity invested capital does not include all "working capital" or all assets used in the business*

The taxpayer makes the further argument (Br. 34–35), in effect, that "equity invested capital" should be construed as including all assets or all working capital, as the Third Circuit erroneously held in *Commissioner* v. *McKay Products*, 178 F. 2d 639, 642. In adopting this view that "equity invested capital" is really the same as the corporation's working capital, the Third Circuit concluded that what should control should be the fact that the property received from the community group there was a part of taxpayer's working capital being used in the business. Of course, the cash and properties received by the taxpayer here are part of the taxpayer's assets, used in the business, and in that sense are part of the taxpayer's "working" capital. The payments were undoubtedly additional assets of the business, and their receipt had the result of showing an increase on the assets side in the taxpayer's financial statement. However, what is included in equity invested capital under Section 718 is restricted to the items specified therein and,

as has been aptly stated, "under § 718, financial statement improvements do not as such augment equity invested capital * * *." *Walsh Holyoke Steam B. Wks.* v. *Commissioner*, 160 F. 2d 185, 188 (C. A. 1st).

The taxpayer's argument amounts to a suggestion that it would be penalizing (Br. 33) a taxpayer using the invested capital method not to permit it to use all working capital in arriving at its credit, while under the alternative method the credit based on income reflects the earnings produced by all assets used in the business and therefore is based upon all working capital. There is no discrimination or penalizing. Congress provided two methods of computing the credit, available in the alternative, and a taxpayer is free to use whichever results in the lesser tax. A taxpayer using the method based on invested capital must compute invested capital in the manner specified by Congress for that method, and cannot complain that under the other method other items are taken into account in the computation of the credit. In final analysis, the taxpayer is really claiming that all of the assets of the business or all working capital should be included under equity invested capital in computing the credit on the invested capital method, because the credit under the income method is based upon the earnings of all the assets. The simple answer is that Congress did not say so. If Congress had intended to so provide, it would have been a simple matter for it to have said so. There is nothing in

the statute or in the reports of the legislative committees to support such a view, or to indicate or even suggest that Congress intended to permit equity invested capital to be computed upon the basis of total assets or total working capital. See Report of Subcommittee (dated August 8, 1940), *supra*, pp. 3, 5, 6–8, 11–12; H. Rep. No. 2894, 76th Cong., 3d Sess., pp. 4–5, 10–11, 24–26 (1940–2 Cum. Bull. 496, 498–499, 503, 513–515); S. Rep. No. 2114, 76th Cong., 3d Sess., pp. 2, 4–5, 6, 14 (1940–2 Cum. Bull. 528, 529, 531, 532, 538–539); and H. Conference Rep. No. 3002, 76th Cong., 3d Sess., pp. 47, 48–49 (1940–2 Cum. Bull. 548, 553, 554–555).

The view that Congress, under the invested capital method, did not intend to allow a credit for all working capital or a credit based upon all of the assets used in the business, is further supported by the fact that the base period "income experience" of the taxpayer was eliminated from the computation of the credit under the invested capital method in the 1940 excess profits tax law. The bill originally passed by the House provided for the invested capital credit to be computed upon the percentage of invested capital which the average earnings during the base period bore to the average invested capital during that period. That provision was as recommended by the Treasury Department (Joint Hearings, *supra*, pp. 69, 70), by the Subcommittee (Report of Subcommittee, *supra*, p. 3) and by the House

Ways and Means Committee (H. Rep. No. 2894, 76th Cong., 3d Sess., pp. 4, 22 (1940–2 Cum. Bull. 496, 498, 512)). The Senate Committee, however, eliminated "base period income experience" from the invested capital method and substituted a provision for the allowance of a flat credit of eight percent of the invested capital for the taxable year alone, which was adopted in conference (see S. Rep. No. 2114, 76th Cong., 3d Sess., pp. 2, 4–5, 14 (1940–2 Cum. Bull. 528, 529, 538), and H. Conference Rep. No. 3002, 76th Cong., 3d Sess., pp. 48–49 (1940–2 Cum. Bull. 548, 554)).

The view that under the invested capital method as finally written into law Congress did not intend to allow a credit for all working capital or for all assets used in the business, is further supported by the formula adopted by Congress for the treatment of inadmissible assets under Section 720 of the Code. This section provides that the average invested capital be reduced by a percentage which is equal to the ratio of inadmissible assets to total assets. In explaining the provision, it was stated that inadmissible assets "are not deducted directly from the invested capital for the reason that the total of admissible and inadmissible assets is not ordinarily equal to the invested capital" (Report of Subcommittee, *supra*, p. 6). See also H. Rep. No. 2894, *supra*, pp. 26–27 (1940–2 Cum. Bull. 496, 515). Congress recognized, and indeed in-

tended that under the invested capital method the credit would not be based upon the total of all of the assets used in the business: It intended that the credit would be based only upon the amount of the aggregate of the items permitted to be included in equity invested capital under Section 718, plus the borrowed capital allowed to be included under Section 719—which aggregate amount it realized would generally be different from the total of all assets.

(c) *The underlying purpose of the law supports our position*

The particular purpose of the statutory provision involved in this issue must be kept in mind, and a conclusion which would frustrate the statutory purpose should be avoided. Cf. *United States* v. *Benedict*, 338 U. S. 692, 696. Here, the statutory provision in question is Section 718, which is a provision granting a credit from the excess profits tax based upon the amount of *equity* capital *invested* in the business venture. In other words, it is one of the provisions written into the law to "establish a measure by which the amount of profits which were 'excess' could be judged". *West Construction Co.* v. *Commissioner*, 7 T. C. 974, 978. See *Commissioner* v. *South Texas Co.*, 333 U. S. 496. See also Report of a Subcommittee of the Committee on Ways and Means, *supra*, pp. 3, 5. See also S. Rep. No. 2114, Part 2, *supra*, p. 12. The computation

of equity invested capital under Section 718 should be upon a realistic test. See *Liberty Mirror Works* v. *Commissioner,* 3 T. C. 1018; *Walsh Holyoke Steam B. Wks.* v. *Commissioner,* 160 F. 2d 185 (C. A. 1st). In this case, when the situation is viewed realistically, it may well be said that "it overtaxes imagination" to regard the community groups, or the persons who contributed cash to them, as making contributions to the "capital" of the taxpayer. See *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98, 102. Section 718 of the Code should not be construed in such a way as to give the extremely favorable tax result contended for by the taxpayer, unless clearly warranted by the language of the statute or by the underlying purpose of the invested capital credit allowed under the excess profits tax law. See *Walsh Holyoke Steam B. Wks.* v. *Commissioner, supra,* p. 188. Neither the language of Section 718 nor the underlying purpose of the invested capital credit warrants such a result.

C. The cash and buildings received by the taxpayer are not includible in its equity invested capital as "accumulated earnings and profits" under Section 718 (a) (4)

On the invested capital issue, the taxpayer makes the alternative contention (Br. 36–55) that the cash and buildings it received from the communities are includible in its equity invested capital under Section 718 (a) (4) as "accumulated earnings and profits" as of the beginning of the

taxable years here involved. This contention is inconsistent with its first contention that the cash and buildings are includible in invested capital as "contributions to capital" under Section 718 (a) (1) and (2). In arguing that the receipts are "contributions to capital" within the meaning of subsections (1) and (2) of Section 718 (a), the taxpayer is claiming that they came in through the route of the "capital," as contrasted to the "income" route, while in arguing that they constitute "accumulated earnings and profits" as of the beginning of the taxable years under subsection (4), the taxpayer is claiming that they have been received through the "income" route.

The alternative contention was correctly rejected by the court below. (R. 156–158.) It runs counter to the fundamental principle in our law of income taxation to the effect that gain which has not been recognized in the computation of net income does not affect "earnings and profits" for tax purposes. *Commissioner* v. *South Texas Co.*, 333 U. S. 496, and *Commissioner* v. *Wheeler*, 324 U. S. 542. See also *Butter-Nut Baking Co.* v. *Commissioner*, 3 T. C. 423, and *Federal Union Insurance Co.* v. *Commissioner*, 5 T. C. 374; cf. *Taylor-Wharton Iron & Steel Co.* v. *Commissioner*, 5 T. C. 768.

As the taxpayer agrees (Br. 39–40), the term "accumulated earnings and profits" used in Section 718 (a) (4) of the Code has the same meaning for the purpose of the excess profits tax as it

has for the purpose of the income tax: Section 728 of the Code and Section 35.718–2 of Treasury Regulations 112 (Appendix, *infra*, pp. 81, 83–84). Even prior to the decision of this Court in the *Wheeler* case, it was an established principle that the same method employed in computing and reporting gains for income tax purposes must be used in determining earnings and profits. See G. C. M. 2951, VII–1 Cum. Bull. 160 (1928); I. T. 3253, 1939–1 Cum. Bull. 178; *Helvering* v. *Alworth Trust*, 136 F. 2d 812 (C. A. 8th), certiorari denied, 320 U. S. 784; *Siegel* v. *Commissioner*, 29 B. T. A. 1289, 1293; *Neptune Meter Co.* v. *Price*, 98 F. 2d 76 (C. A. 2d); *Wells Fargo Bank & Union Trust Co.* v. *McLaughlin*, 78 F. 2d 934 (C. A. 9th), certiorari denied, 296 U. S. 638.

If any doubt remained that unrecognized gains or losses did not affect earnings and profits, it was removed by Section 115 (l) of the Code, as this Court recognized in the *Wheeler* case. For many years, the Commissioner had consistently taken the position that gains or losses which are not recognized for income tax purposes neither increase nor diminish earnings or profits, but, in view of certain adverse holdings,[31] Congress set the matter at rest in 1940 by adding subsection (l) to Section 115 of the Internal Revenue Code (Appendix, *infra*, pp. 75–76), by Section 501 of

[31] As appears from H. Rep. No. 2894, *supra*, one of the purposes of the amendment was to overrule the principle applied in the case of *Commissioner* v. *F. J. Young Corp.*, 103 F. 2d 137 (C. A. 3d), and similar holdings.

the Second Revenue Act of 1940. See H. Rep. No. 2894, 76th Cong., 3d Sess., p. 41 (1940–2 Cum. Bull. 496, 526–527).[32] Section 115 (l), after setting out the method for the computation of gain or loss from the sale of property by a corporation, provides that "Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made". Section 115 (l) is a clear expression of a Congressional intent to provide that gain will not affect earnings and profits until it has been recognized in the computation of net income. Without directly resting on Section 115 (l), the decision of this Court in the *Wheeler* case confirmed the principle above mentioned: The holding of the Court in the *Wheeler* case correlates not only the extent to which, but the time when, gain shall be brought into earnings and profits with the extent to which and the time when such gain enters into the computation of net income. This Court, in the *South Texas* case, gave effect to the purpose of Section 115 (l) and applied it directly.

[32] This is the same Act by which Congress added the excess profits tax provisions to the Code, and in H. Rep. No. 2894, *supra*, it was noted that the proposed amendment, to add subsection (l) to Section 115 of the Code, would also be important in determining equity invested capital for excess profits tax purposes.

The taxpayer has not taken the position that upon the receipt of the cash and buildings it realized taxable income, but on the contrary asserts (Br. 38) that the receipts were not taxed to it as income[33] in reliance upon G. C. M. 16952, 1937–1 Cum. Bull. 133.[34] Since they have not been taxed as income upon their receipt, the cash and buildings can no more affect earnings and profits consistently with the assumed taxless character of the transaction than could the realized but unrecognized gains in the *Wheeler* case, or the unrecognized gains on installment sales in the *South Texas* case. As held in the *Wheeler* case, the policy of the revenue laws requires the use of the same basis in determining gains and losses which are to be brought into "earnings and profits" as that used in determining the gains and losses which are to be brought into the income account for the corporation's income tax. Here, as we have seen under point I above, the basis for determining gain and for depreciation on the investments in property which the taxpayer has not

[33] As already noted, both the Tax Court (R. 24) and the court below (R. 158) assumed that the cash and buildings had not been taxed as income to the taxpayer upon their receipt.

[34] The view expressed in that memorandum was based upon *Edwards* v. *Cuba Railroad*, 268 U. S. 628, and certain Board of Tax Appeals decisions following it, such as *Frank Holton & Co.* v. *Commissioner*, 10 B. T. A. 1317. See also *Tampa Electric Co.* v. *Commissioner*, 12 B. T. A. 1002. Whether the *Cuba Railroad* case and its progeny represent a correct view of the law is a question that has not been put in issue by the parties to this case.

made is zero, and hence that is the basis for determining the amounts which may be included in "earnings and profits". Only at the time when, and to the extent that, the taxpayer realizes income from the buildings and equipment, either contributed to it or acquired with contributed cash, may the "earnings and profits" account be increased. *Commissioner* v. *South Texas Co.*, 333 U. S. 496. See also *Butter-Nut Baking Co.* v. *Commissioner*, 3 T. C. 423, and *Federal Union Insurance Co.* v. *Commissioner*, 5 T. C. 374; cf. *Taylor-Wharton Iron & Steel Co.* v. *Commissioner*, 5 T. C. 768.

The taxpayer argues that the *South Texas* case is inapplicable here, asserting (Br. 37–38, 39) that there is no "deferment of income" here, as there was in the *South Texas* case under Section 44 of the Internal Revenue Code. True, no installment sales under Section 44 are involved here, but the receipt of cash and property which had not been taken into income at the time received is, in substance, identical with the nonrecognition of the gains in the *South Texas* case.

The taxpayer argues that the payments and property it received from the communities were subject to distribution as earnings and profits, that such distribution would have constituted a taxable dividend, and that, therefore, the amount thereof is includible in its "accumulated earnings and profits". (Br. 50–54.) The argument, we believe, misses the real point involved, which is

not *whether* these receipts ever come into earnings and profits, but *when* they come into earnings and profits. In apparent reliance upon the decision in *Edwards* v. *Cuba Railroad*, 268 U. S. 628,[35] these receipts were not taken into income at the time of their original receipt. Thus, since under the *Detroit Edison* case no depreciation deductions are allowable on the properties (to the extent that the taxpayer has made no investment therein), an aliquot portion of them is in effect being taken into earnings and profits each year by reason of the fact that the income to be taken into earnings and profits is not reduced by a depreciation deduction. Consequently, by the end of their useful life, the entire amount of these properties will be reflected in accumulated earnings and profits.[36] On the other hand, if the taxpayer, instead of retaining them for their complete useful life, should sell the buildings or machinery at any prior time, then whatever is realized out of their sale will come into income at that time (since the entire amount would then be taxable as gain, the taxpayer's basis being zero) and will

[35] See *supra*, note 34, p. 65.

[36] The taxpayer asserts (Br. 55, 59) that it has been allowed depreciation deductions in the past years on the buildings it received and on the full cost of the buildings and equipment in the communities from which it received cash. The record is silent as to this, and also as to what, if any, effect such deductions might have had on its accumulated earnings and profits. The record merely shows that it had, at all times material to the issues in this case, accumulated earnings and profits in excess of the amount of $971,031.01. (R. 129.)

then enter into earnings and profits. *Commissioner* v. *South Texas Co.*, 333 U. S. 496.

The taxpayer points to the fact that the Regulations, in Section 29.115–3 of Treasury Regulations 111, provide for the inclusion in earnings and profits of items which are not taxable as income when received. (Br. 38.) That there are such items is immaterial to the present question. Such items are merely exceptions to the general rule that earnings and profits for tax purposes include only what has been taken into income, and the existence of such exceptions is not inconsistent with what we have stated is the correct concept of earnings and profits, since earnings and profits in the tax sense do not correspond exactly to taxable income, nor do they necessarily follow income in the accounting sense. *Commissioner* v. *Wheeler*, 324 U. S. 542. But, to qualify as "earnings and profits" it is necessary that the item in question at least be received as income, i. e., as gain or profit, even if, at the time, the gain is not recognized. Here, the receipts involved are not items that have been deemed received as income, but receipts which have been treated as not being taxable as income on the theory that they constituted reimbursement to the taxpayer "for capital expenditures", in reliance upon *Edwards* v. *Cuba Railroad*, 268 U. S. 628, 632.[*] (See *supra*, note 34, p. 65.)

[*] The same distinction is applicable to such cases as *Ayer* v. *Commissioner*, 12 B. T. A. 284; *Cummings* v. *Commis-*

The fact that the buildings and cash received by the taxpayer have been taken into the earned surplus account on the taxpayer's books (R. 30–31) and, as the taxpayer asserts (Br. 37), have at all times been reflected in its "surplus account on the liability side of its balance sheet" does not make them part of "accumulated earnings and profits" for tax purposes. Bookkeeping entries are not controlling in tax matters. *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216; *Bazley* v. *Commissioner*, 331 U. S. 737; *Edwards* v. *Douglas*, 269 U. S. 204. Further, the fact that the reflection of the cash and buildings in "earnings and profits" on the taxpayer's books may have been in keeping with "established accounting principles", as the taxpayer suggests (Br. 39), is immaterial. As already stated, the computation of earnings and profits in the tax sense "does not necessarily follow corporate accounting concepts". *Commissioner* v. *Wheeler*, 324 U. S. 542, 546. See also *Commissioner* v. *Estate of Bedford*, 325 U. S. 283.

---

sioner, 73 F. 2d 477 (C. A. 1st); *Schweppe* v. *Commissioner*, 8 T. C. 1224, affirmed, 168 F. 2d 284 (C. A. 9th), relied upon by the taxpayer in this connection. (Br. 43–47.) That items of *income* are part of earnings and profits is of no significance here. Likewise, whether gifts to a corporation may be included in earnings and profits, as the taxpayer argues (Br. 46, 47–48), is not material here: The taxpayer did not receive "gifts". See part I of Argument, *supra*. See also G. C. M. 16952, 1937–1 Cum. Bull. 133, and Section 86.8 of Treasury Regulations 108.

CONCLUSION

The decision of the court below is correct and should be affirmed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

STANLEY M. SILVERBERG,
ELLIS N. SLACK,
LEE A. JACKSON,
HARRY MARSELLI,
Special Assistants to the Attorney General.

APRIL 1950.

APPENDIX

INTERNAL REVENUE CODE

CHAPTER 1—INCOME TAX

* * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(l) [as amended by Section 121 (c) of the Revenue Act of 1942, c. 619, 56 Stat. 798 [37]] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, * * *

* * * * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

[37] By Section 121 (d) of the Revenue Act of 1942, the amendment to Section 23 (l) of the Code was made applicable to taxable years beginning after December 31, 1938.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(2) *Gifts after December 31, 1920.*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that for the purpose of determining loss the basis shall be the basis so determined or the fair market value of the property at the time of the gift, whichever is lower. * * *[1]

* * * * *

(4) *Gift or transfer in trust before January 1, 1921.*—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition.

* * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

[1] This section was amended by Section 143 (a) of the Revenue Act of 1942, effective for taxable years beginning after December 31, 1941, in a respect not material to this case.

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) [as amended by Section 130 (b) of the Revenue Act of 1942, *supra*] For expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

* * * * *

(2) *Substituted basis.*—The term "substituted basis" as used in this subsection means a basis determined under any provision of subsection (a) of this section or under any corresponding provision of a prior income tax law, providing that the basis shall be determined—

(A) by reference to the basis in the hands of a transferor, donor, or grantor, or

(B) by reference to other property held at any time by the person for whom the basis is to be determined.

* * * * *

(26 U. S. C. 1946 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

(26 U. S. C. 1946 ed., Sec. 114.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.[*]

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from

[*] Section 115 (a) and (b) was amended by Sections 166 and 186 of the Revenue Act of 1942, and Section 512 of the Revenue Act of 1943, in respects not here material.

the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

* * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1939, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934, 48 Stat. 712, or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

---

[*] By Section 501 (b) of that Act, subsection (1) of Section 115 of the Code was made applicable to taxable years

* * * * *

(l) [as added by Section 501 (a), Second Revenue Act of 1940, c. 757, 54 Stat. 974 ¶] *Effect on Earnings and Profits of Gain or Loss and of Receipt of Tax-Free Distributions.*—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

(1) for the purpose of the computation of earnings and profits of the corporation, shall be determined, except as provided in paragraph (a), by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(2) for the purpose of the computation of earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing net income under the law applicable to the year in which such sale or disposition was made. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 115.)

---

beginning after December 31, 1938, and by Section 501 (c) it was made effective as to the Revenue Act of 1938 and any prior Revenue Act as if a part thereof at the time of its enactment.

CHAPTER 2—ADDITIONAL INCOME TAXES

* * * * *

SUBCHAPTER E—EXCESS PROFITS TAX

[As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940"]

SEC. 710. IMPOSITION OF TAX.

(a) *Imposition.*—There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1939, on the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax as follows:

* * * * *

(b) *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

(1) *Specific exemption.*—A specific exemption of $5,000;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under section 712; and

(3) *Unused excess profits credit.*—* * *

(26 U. S. C. 1946 ed., Sec. 710.)

SEC. 711.—EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(26 U. S. C. 1946 ed., Sec. 711.)

SEC. 712 [as amended by Section 13 of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17 *] EXCESS PROFITS CREDIT—ALLOWANCE.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In

* By Section 17 of the Excess Profits Tax Amendments of 1941 the amendments made by that Act were made effective as of the date of the enactment of the Excess Profits Tax Act of 1940.

the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess profits credit in case of certain reorganizations of corporations, see section 741.)

* * * * *

(26 U. S. C. 1946 ed., Sec. 712.)

SEC. 713. EXCESS PROFITS CREDIT—BASED ON INCOME.

* * * * *

(26 U. S. C. 1946 ed., Sec. 713.)

SEC. 714. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

The excess profits credit, for any taxable year, computed under this section, shall be an amount equal to 8 per centum of the taxpayer's invested capital for the taxable year, determined under section 715.[3]

(26 U. S. C. 1946 ed., Sec. 714.)

SEC. 715. DEFINITION OF INVESTED CAPITAL.

For the purposes of this subchapter the invested capital for any taxable year shall be the average invested capital for such year, determined under section 716, reduced by an amount computed under section 720 (relating to inadmissible assets). * * *

(26 U. S. C. 1946 ed., Sec. 715.)

---

[3] The amount of the credit was variously modified, by reductions on a graduated basis, by amendments to Section 714 of the Code made, successively, by Section 201 (b) of the Revenue Act of 1941, Section 217 of the Revenue Act of 1942, and Section 205 of the Revenue Act of 1943.

SEC. 716. AVERAGE INVESTED CAPITAL.

The average invested capital for any taxable year shall be the aggregate of the daily invested capital for each day of such taxable year, divided by the number of days in such taxable year.

(26 U. S. C. 1946 ed., Sec. 716.)

SEC. 717. DAILY INVESTED CAPITAL.

The daily invested capital for any day of the taxable year shall be the sum of the equity invested capital for such day plus the borrowed invested capital for such day determined under section 719.

(26 U. S. C. 1946 ed., Sec. 717.)

SEC. 718. EQUITY INVESTED CAPITAL.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

(1) *Money paid in.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) [as amended by Section 218 of the Revenue Act of 1942, *supra*] *Property paid in.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property

was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115 (l) for determining earnings and profits;

* * * * *

(4) *Earnings and profits at beginning of year.*—The accumulated earnings and profits as of the beginning of such taxable year; * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 718.)

SEC. 728. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

(26 U. S. C. 1946 ed., Sec. 728.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.113 (a) (8)-1. *Property Acquired by a Corporation After December 31, 1920.*—The acquisition of property by a corporation after December 31, 1917, by the issuance of its stock or securities may not fall within the provisions of section 113 (a) (7), because of the fact that the property was not acquired in connection with a reorganization. If, however the acquisition of such property occurred after December 31, 1920, and falls within the provisions of section 113 (a) (8), the limitations therein imposed upon the basis of such property are applicable.

In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, or from any person as a contribution to capital, the basis

of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift, the basis thereof shall be determined under section 113 (a) (2).

Similar provisions were contained in the previous Regulations relating to the income tax under the Internal Revenue Code, Treasury Regulations 103, in Section 19.113 (a) (8)–1.

Treasury Regulations 112, promulgated under the Internal Revenue Code:

> SEC. 35.718–1 *Determination of Daily Equity Invested Capital—Money and Property Paid in.*—The equity invested capital for any day is determined as of the beginning of such day. The basis or starting point is found in the amount of money and property previously paid in for stock, or as paid-in surplus, or as a contribution to capital. * * * For the purpose of determining equity invested capital, the amount of any property paid in is the unadjusted basis to the taxpayer for determining loss upon a sale or exchange under the law applicable to the taxable year for which the invested capital is being computed. * * *
>
> * * * * *
>
> If the property was acquired after December 31, 1920, by a corporation from a shareholder as paid-in surplus or from any person as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor if the transfer had not been made. (See section 113 (a) (8).) If so acquired prior to January 1, 1921, the

basis is the fair market value of the property at the time it was paid in. Where the basis is the transferor's basis, those adjustments shall be made to such basis with respect to the period before the property was paid in as are proper under section 115 (l) for determining earnings and profits. Thus, if A paid into a corporation in 1930 as paid-in surplus certain improved real estate purchased by him in 1920 for $20,000, with respect to which depreciation was allowed for the period held by him in amounts aggregating $6,000 (the full amount allowable), A's basis of $20,000 shall be reduced by $6,000 for the purpose of computing the invested capital of the corporation.

* * * * *

SEC. 35.718–2 *Determination of Daily Equity Invested Capital—Accumulated Earnings and Profits.*—(*a*) *In general.*—The term "accumulated earnings and profits" is not defined in the Internal Revenue Code. See, however, section 115 and the regulations prescribed thereunder as to the effect of certain transactions on earnings and profits, and section 35.718–5 as to the effect of the declaration and distribution of dividends. In general, the concept of "accumulated earnings and profits" for the purpose of the excess profits tax is the same as for the purpose of the income tax. As to determination of additional amount to be included in daily equity invested capital on account of new capital, see section 35.718–4. In computing accumulated earnings and profits as of the beginning of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall subtract the income and excess profits taxes for the preceding taxable year. If there is a deficit in the

accumulated earnings and profits as of the beginning of the taxable year, such deficit shall not be taken into account in determining invested capital, and in such cases the earnings and profits as of the beginning of the taxable year shall be considered as zero, but subsequent earnings and profits shall be applied against such deficit. Unrealized appreciation in value of property is not a factor in determining earnings and profits.

* * * * *

Similar provisions were contained in the previous Regulations relating to the excess profits tax under the Internal Revenue Code, as amended, Treasury Regulations 109, in Sections 30.718–1 and 30.718–2.

U. S. GOVERNMENT PRINTING OFFICE 1950